B. The Bank's prudential tasks in practice: focus areas in 2023

1. Banking turmoil

1.1 Factual background

During the first half of the year, turbulence shook the global banking sector. Macroeconomic conditions (high inflation, a sharp rise in interest rates and more limited economic growth) severely disrupted the financial markets and also weighed heavily on the sector (see Figure 1.7 in chapter 1 in the "Economic and financial developments" section of this report). The rise in monetary policy rates created expectations of higher interest rates for savings and other deposits (see section B.4), drove up banks' overall funding costs, and, at the same time, put pressure on the value of fixed-income bond and securitisation portfolios. Monitoring the quality of banks' credit portfolios and managing their interest rate and liquidity risks became major concerns.

It is against this backdrop that some medium-sized regional credit institutions in the US (Silicon Valley Bank, Signature Bank, Silvergate Bank and First Republic Bank) lost the confidence of depositors and investors in early 2023, leading to a sudden and large-scale withdrawal of deposits (a "bank run"). This loss of confidence was related to the single-minded business model of these banks (focused, for example, on lending to the technology industry or the provision of banking services for crypto assets) and their concentrated deposit base (for example, a high concentration of deposits from technology firms or high net worth individuals). In addition, a significant share of these banks' deposits was not covered by federal deposit insurance. Ineffective management of interest rate and liquidity risk by these institutions, combined with rapidly rising interest rates, also contributed to their difficulties. Deregulation during the Trump administration and insufficiently effective supervision also played an important role. This shaken confidence, combined with concerns as to the stability of these banks, set off a chain reaction, with depositors transferring their funds to safer havens, notably larger credit institutions, seen as providing greater security, and money market funds, thereby exacerbating the situation. In March and April, the US government had to intervene decisively and take control of the affected banks in order to guarantee financial stability.

The Swiss bank Credit Suisse also completely lost the confidence of the financial markets in March 2023. The bank had experienced a succession of scandals in recent years, including money laundering violations, poor risk management, restructuring and difficult cases, and had repeatedly reported losses. Having suffered further losses, the bank announced a major restructuring in the second half of 2022, accompanied by a capital increase of CHF 4 billion to absorb the resulting losses. The turbulence on the financial markets completely undermined the already shaky confidence in this fragile bank, and the Swiss authorities had to intervene to ensure financial stability. The bank was eventually acquired by UBS, another Swiss bank, for a low price. To cover the losses, the Swiss supervisory authority wrote off in full the additional tier 1 or AT1 securities issued by the bank. These are subordinated debt securities that can be converted into capital or, conversely, written down in full in the event of a crisis. The central bank provided emergency liquidity assistance and the Swiss government granted substantial financial guarantees

to the purchaser. Credit Suisse shareholders received the sales proceeds from the acquirer, UBS, in exchange for their shares, while the holders of AT1 securities were left out in the cold. The latter took legal action, which caused turbulence on the secondary market for AT1 securities.

In the days and weeks following this intervention by the US and Swiss authorities, the financial markets became very nervous, and the financial sector became seriously concerned about similar vulnerabilities in the global banking sector. Business models based on a concentrated deposit base or a high percentage of uninsured deposits came to be seen as more vulnerable. Specialists also expressed concerns about the size and composition of liquidity reserves. The adequacy and nature of these buffers play a crucial role in a bank's ability to meet its short-term commitments. Unrealised losses on bonds in banks' investment portfolios, particularly in held-to-maturity portfolios, where losses do not appear on the income statement, were also scrutinised. Finally, attention was paid to the management by banks of interest rate risk. Credit institutions with deficient interest rate risk management may be ill-equipped to adapt to a fluctuating interest rate environment, which is likely to put a strain on their profitability, the stability of their funding sources and, more generally, their financial health.

However, the crisis of confidence did not spread to other European countries or to the Belgian banking sector. Belgian banks, and by extension the banking sector in the euro area, stood up well to the turbulence in the financial markets and the events in the US and Swiss banking sectors. The sector's direct and indirect exposure to the US and Swiss institutions concerned was negligible. Belgian banks have a more robust financial profile, with a large but much more diversified deposit base. Some 60 % of these deposits are insured by the Belgian deposit guarantee scheme, which offers a significant level of protection, helping to ensure the stability of this source of funding. In addition, Belgian banks maintain substantial capital buffers, in which AT1 securities are largely absent, and have strong liquidity buffers, largely constituted by reserves with the central bank, which ensure that in a problematic situation, they do not initially need to turn to external funding to meet their short-term commitments. In brief, the Belgian banking sector has a more balanced financial profile, based on a well-diversified deposit base, a high share of guaranteed deposits, effective risk management practices, and comfortable levels of capital and liquidity.

1.2 Impact on supervision and regulation

The situation of European and Belgian banks therefore differs in many respects from that of banks such as Silicon Valley Bank or Credit Suisse. And the supervisory framework differs too, particularly from that applied in the United States to medium-sized banks, which are not subject to the Basel standards for banking supervision in effect worldwide and applicable to all European banks. Nevertheless, in the wake of recent turbulence, introspection by European banks and supervisory and regulatory authorities is called for, particularly with regard to the regulations in force, the effectiveness of banking supervision and the resolution framework for struggling banks.

The crisis highlighted the need to continue to maintain a sound and credible regulatory and prudential framework for the banking sector. Such a framework helps strengthen the stability of the banking system and the confidence of financial actors, investors and depositors. The adoption of the latest parts of the Basel III standards, reformed and strengthened in the wake of the 2008 global financial crisis, into European banking regulations, which took the form of a European "banking package", is therefore more than welcome.[1] On the other hand, it is regrettable that European lawmakers have once again inserted a number of significant derogations from the Basel standards and provided for lengthy transition periods. This is all the more unfortunate given that the EU is already the only jurisdiction subject to the Basel Committee on Banking Supervision (BCBS) whose regulations derogate significantly from the Basel capital standards. These derogations water down the rules applicable to European banks.

The Basel Committee on Banking Supervision will also examine the impact of the crisis and the adequacy of existing international standards. The Committee has published a report[2] and

1 The European banking package includes amendments to European banking legislation aimed at implementing the latest parts of the Basel III standards, which are applicable worldwide, while clarifying certain powers of the banking supervisory authorities and certain obligations of banks.

2 BCBS, Report on the 2023 banking turmoil (5 October 2023).

an analysis of the events, including reflections on their impact on supervision and regulation. These reflections focus in particular on liquidity regulation in the context of the heightened volatility of certain sources of financing and deposits in the digital age, including the absence of provisions on deposit concentration. The approach to interest rate risk management by banks, which currently have considerable leeway in the regulatory arena, is also being scrutinised. Banking supervisors must continue to ensure that the existing regulatory and supervisory framework remains robust and armed against potential and future risks.

Against this difficult backdrop, the SSM reviewed its priorities. The ex-post analyses carried out by the US supervisory authorities of the problems of certain US banks identified, in particular, deficient risk management and weak governance in the credit institutions concerned, as well as ineffective supervision and regulation of these institutions. As the supervisor of Europe's largest banks, the SSM has taken these findings into account in determining its approach and policies. The potential impact on European banks of the normalisation of monetary policy, principally in terms of liquidity and interest rate risk, was already a priority for prudential supervisors, principally the ECB, which in particular carried out a review of banks' financing plans in the context of the gradual repayment of long-term refinancing operations. In view of the problems encountered by some US banks, particularly following the rapid rise in interest rates, the European supervisory authorities, including the ECB and the Bank, stepped up their monitoring of banks' sensitivity to rising interest rates, in terms of both income and liquidity. Particular attention has been paid to the level of unrealised losses in European banks' portfolios of securities carried at amortised cost and their ability to absorb these losses.[1] The adequacy of banks' interest rate risk management, funding plans and potential emergency liquidity measures will remain a prudential priority in the short term.

The bank failures in the first half of 2023 in the United States and Switzerland were the first real large-scale test of the international resolution framework established in the wake of the 2008 financial crisis. The measures taken by the US and Swiss authorities yielded lessons that are relevant not only for the functioning of the European resolution regulatory framework but also for the practices of resolution authorities.

It seems important to look more closely at the ability of resolution authorities to deal with the failure of systemically important banks. The measures taken by the Swiss authorities were a reminder that, faced with the failure of a large group, the resolution framework must offer sufficient alternatives to resolve different types of shocks and situations. Insofar as a bail-in may prove complex to implement and the framework provides for the possibility of using this instrument in combination with another tool, it appears important to continue to identify and make operational a number of alternative resolution strategies in order to offer greater options in the event of a crisis.

It is also important that the actions of the resolution authorities remain sufficiently predictable. In this context, shortly after the Swiss measures, the ECB, the Single Resolution Board (SRB) and the European Banking Authority (EBA) issued a joint statement reaffirming the sequence that would be followed in the event of a bail-in within the banking union, thereby helping to strengthen understanding (by banks, authorities and markets) of how this tool would be used. Finally, the crisis situations in the first half of 2023 are a reminder of how sudden liquidity withdrawals can very quickly weaken a credit institution. The speed with which Silicon Valley Bank's depositors withdrew their assets was unprecedented. This is a reminder of the need to provide a decisive response, in the framework of the European Banking Union, to the question of liquidity provision in the event of resolution, an issue which to date has not been insufficiently addressed.

Given the continuing structural challenges facing the banking sector, it is imperative to consider an appropriate regulatory, resolution and supervisory framework, in cooperation with the banks concerned, the supervisory and regulatory authorities, and the broader financial community, in order to continue to strengthen confidence in the sector and, where necessary, contain the impact of shocks.

1 ECB, "Unrealised losses in banks bond portfolios measured at amortised cost", 28 July 2023.

2. Recent adjustments to macroprudential policy in Belgium

The Bank is the macroprudential authority in Belgium. In this capacity, the Bank closely monitors developments in the financial sector and works in particular to identify risks that could jeopardise financial stability. Where necessary, it can take measures to ensure the stability of the financial sector. These measures can be of various kinds, for example the imposition of additional capital requirements based on developments in the financial cycle, specific exposures in the financial sector or the systemic nature of certain institutions. The main objective of this type of measure is to increase the resilience of the financial sector. The Bank can also take measures to orientate the credit policy of financial institutions, the main aim of which is to prevent the development of new risks. The most recent macroprudential decisions taken by the Bank are briefly presented below. The Bank's annual Macroprudential Report, part of its Financial Stability Report, presents the macroprudential framework in more detail.

In recent years, macroprudential policy decisions have been taken in an uncertain environment, characterised by a succession of crises of various types and with different origins. The latest decisions, taken against the backdrop of a tightening of monetary policy which, among other things, led to a downturn in the financial and property cycles, were aimed at increasing the resilience of the Belgian financial sector and encouraging the maintenance of sound lending policies, while taking care not to unduly dampen the dynamism of the credit cycle.

2.1 Residential property market

The Bank continues to closely monitor property market risks. As part of its macroprudential tasks, the Bank has been closely monitoring developments on the Belgian residential property market for many years. Based on this monitoring and its analyses, it has also taken various measures.

The Bank is maintaining its prudential expectations for new mortgages but welcomed the recent moderate increase in the duration of new loans. In early 2020, the Bank introduced prudential expectations for mortgage lenders. One of the aims of these recommendations was to improve the average credit quality of new mortgages, in particular by reducing the proportion of loans with a high loan-to-value ratio and thus to ensure that the risks observed in mortgage loan portfolios remained under control. This first objective has been met, as the financial sector followed the Bank's recommendations. The Bank's expectations were also intended to be flexible so as not to curb access to the mortgage market for creditworthy borrowers, particularly young people. This second objective has also been met, as the share of young people among recent mortgage borrowers has not fallen. Firstly, this reflects the sufficient leeway afforded to lenders by the recommendations, particularly with regard to the origination of high loan-to-value loans to first-time buyers. However, in an environment characterised by rising interest rates, as has been the case since mid-2022, it is expected that mortgage interest rates, rather than loan-to-value limits, will limit the borrowing capacity of prospective buyers, assuming a constant monthly debt service burden and maturity. It is against this backdrop – and based on the assumption that the monthly budget required to repay a mortgage is in most cases a substantial constraint – that the Bank welcomed the moderate extension of the maturities of new mortgages, begun in 2022, mainly for young borrowers, as this will help preserve household borrowing capacity when mortgage rates rise and thus prevent an excessive slowdown in mortgage lending and market dynamism. In the past, when mortgage rates were low, the Bank had encouraged lenders only to lengthen the duration of mortgage loans when interest rates rose again, which has been the case since mid-2022. Chapter 7 of the Economic and Financial Developments section of this report provides more information on recent developments in Belgian mortgage portfolios.

The Bank recalibrated downwards the capital buffer for risks on the residential property market. Since 2013, the Bank has required the Belgian banking sector to hold a specific macroprudential capital buffer for risks on the residential property market, due to its high exposure to this market in the form of mortgage loans. This measure was extended and adapted on several occasions. At the end of August 2023, the Bank announced that, particularly in view of the success of its prudential expectations for new Belgian mortgage loans (see above), it was of the opinion that the sectoral capital buffer for systemic risk relating to Belgian mortgage loan portfolios could be reduced. The improvement in the quality of new loans granted since 2020 has been such that it has gradually led to a reduction in the

risk associated with these loan portfolios. As a result, on 1 April 2024, the sectoral buffer for systemic risk relating to Belgian mortgage loans will be lowered from 9 % of the value of the risk-weighted assets concerned to 6 %. In practice, the total amount of the buffer will fall from around € 2 billion to around € 1.3 billion. As indicated in the past, the Bank is prepared to release this macroprudential capital buffer in the event, for example, of a substantial worsening of payment difficulties for mortgage borrowers.

The Bank pays close attention to the energy efficiency of real estate exposures in the Belgian financial sector. At the end of 2020, based on financial stability considerations, the Bank issued a macroprudential circular detailing its expectations and requests for data regarding how the energy efficiency of property exposures is taken into account in the management of climate-related risks by the financial sector. In monitoring these expectations, the Bank noted that the financial sector has made significant progress in this area, for example in terms of the quality of the information collected and the extent of data coverage (see section B.6.1).

2.2 Countercyclical capital buffer

In 2022 and the first half of 2023, against a backdrop of high uncertainty, the Bank decided not to reactivate the countercyclical capital buffer. The purpose of this buffer is to ensure that banks have sufficient room to manoeuvre when economic conditions deteriorate and credit losses materialise. It was activated in 2019 by the Bank, given the dynamic credit developments observed at the time, but was released when the Covid-19 pandemic began. From early 2022 to mid-2023, although it had initially considered reactivating this capital requirement, the Bank decided, in view of the high degree of uncertainty resulting from a potential energy crisis, a downturn in the credit and property cycles and turbulence in the US and Swiss banking sectors, to maintain the countercyclical capital buffer rate at 0 % to ensure that Belgian banks had full flexibility to use their ample capital buffers to proactively increase lending and support the real economy. In this way, the Bank aimed to avoid acting in a pro-cyclical manner and amplifying any tightening of lending conditions that might have occurred.

The Bank announced the reactivation of the countercyclical capital buffer at the end of August 2023 in order to increase the resilience of the financial sector. In view of reduced uncertainty as to the short-term impact of rising interest rates on the economy and the orderly slowdown in the credit and property cycles, the Bank announced on 31 August 2023 that it would reactivate the

countercyclical capital buffer. In taking this decision, the Bank considered that the risk of acting in a pro-cyclical manner had diminished significantly and was now outweighed by the benefits of increasing the resilience of the banking sector. Indeed, the fact that much of the short-term uncertainty has been reduced does not mean that credit losses cannot increase in the future. The transmission of tighter financial conditions to the real economy is a gradual process, one that is still ongoing. As a result, banks could be exposed to higher-than-expected losses, particularly in corporate loan portfolios not covered by the existing capital buffer for mortgage loan portfolios (see above). These losses could arise from the materialisation of risks that had remained latent when interest rates were low, credit and liquidity conditions favourable, and asset prices high. With banks' provisions for credit losses back to levels comparable to those before the pandemic, the reactivation of the countercyclical buffer will increase their resilience to potentially higher-than-expected losses. In concrete terms, the Bank's decision will lead to the effective formation of an additional buffer of around € 1.1 billion on 1 April 2024, corresponding to a countercyclical buffer rate of 0.5 % (applicable to the risk-weighted assets concerned), and of around € 2.3 billion on 1 October 2024, corresponding to a rate of 1 %. As is the case for the buffer intended to cover risks on the residential property market, the Bank may, if it deems necessary, release the countercyclical capital buffer in order to provide the financial sector with additional leeway to support the Belgian economy.

2.3 Systemically important institutions

The additional capital requirement applied to national systemically important banks was maintained and, in one case, increased. As a macroprudential authority, the Bank also imposes specific capital requirements on so-called domestic systemically important banks in order to increase their resilience, given the high economic and social costs their failure would entail. This capital requirement depends on the size of the bank: it amounts to 0.75 % of risk-weighted assets for three banks and 1.5 % for five larger institutions. These buffers are relatively large: at the end of 2022, they represented a total of more than € 5 billion. As the systemic nature of Euroclear has increased significantly following the imposition of sanctions on Russia, the Bank raised the capital requirement applicable to this institution from 0.75 % of risk-weighted assets to 1.5 %, effective 1 January 2024. The additional requirement applicable to other institutions remained unchanged.

2.4 Overall development of macroprudential policy in Belgium

The Bank's recent decisions increase the overall resilience of the banking sector. At the same time, macroprudential actions are supporting access to credit, particularly for young borrowers. The Bank's latest decisions on the sectoral buffer for Belgian mortgage risk and the countercyclical capital buffer will increase the overall resilience of the Belgian banking sector to higher-than-expected losses, with the downward recalibration of the former more than offset by activation of the latter. Taken together, these two macroprudential capital buffers will rise from the current level of € 2 billion to € 2.5 billion on 1 April 2024 and to € 3.6 billion on 1 October 2024. At the same time, while the Bank maintained its prudential expectations for new mortgage lending, it welcomed the moderate lengthening of maturities for new mortgages. This followed previous communication by the Bank that it would only consider lengthening mortgage terms when interest rates rose, which has been the case since mid-2022.

3. FSAP: assessment of the Belgian financial sector and IMF recommendations

As announced in the Bank's 2022 annual report, the IMF carried out an assessment of the Belgian financial sector and financial regulation in 2023. The Financial Sector Assessment Program (FSAP) is a five-yearly exercise for countries with a systemically important financial sector, such as Belgium. The country was last assessed in 2017.

This analysis forms part of the IMF's surveillance activities, as do its Article IV missions, during which it conducts a broad analysis of the socio-economic policy of the member state in question. An FSAP is an IMF analysis of the financial sector which addresses three main themes.

Firstly, the IMF assesses the resilience of the financial sector, to identify systemic risks and possible sources of contagion between financial sectors. An essential tool for the IMF to examine the resilience of the financial sector is the stress test.

In this respect, the IMF assesses the influence of extreme macroeconomic shocks on the solvency and/or liquidity of banks, insurance and reinsurance companies, and investment funds, for example.

Secondly, the IMF verifies the quality of the supervisory framework. On the one hand, the IMF examines the microprudential supervisory framework, against the Basel Committee's Core Principles for Effective Banking Supervision and the Insurance Core Principles of the International Association of Insurance Supervisors. As far as banks are concerned, given that the SSM supervises significant institutions (SIs), the IMF limits its assessment to less significant institutions (LSIs). On the other hand, a significant part of the IMF's work focuses on macroprudential supervision. For the Bank, the FSAP provided an opportunity for an external review of the institutional framework for macroprudential policy and the risk analysis framework in Belgium. The IMF also examined macroprudential instruments, including the countercyclical capital buffer, which was recently reactivated. It also analysed the Bank's performance of risk-based supervision as part of the fight against money laundering and the financing of terrorism. Finally, the IMF assessed compliance by Euroclear Bank [1] with the CPMI-IOSCO [2] [3] principles for financial market infrastructures, [4] including an assessment of the competent supervisory authorities, namely the Bank and the Financial Services and Markets Authority (FSMA).

Thirdly, the FSAP focuses on the crisis management tools available to the member state to prevent and combat financial crises. To this end, the IMF holds discussions not only with the supervisory authority but also with the other crisis management players, such as the resolution authority (in Belgium, the Bank via its Resolution Board) and the deposit guarantee scheme (in Belgium, the Guarantee Fund for financial services).

The FSAP generally includes several missions. For example, the IMF's visit to Belgium consisted of a short preparatory mission at the end of 2022 (remotely) and two in-depth missions in 2023 (on site), each lasting around three weeks. During these missions, various IMF experts held discussions with the Bank, the FSMA, the Federal Public Service Finance, the Ministry of Finance, the aforementioned crisis management players and a range of market operators and experts. The IMF also organised meetings with the ECB.

At the end of 2023, the IMF's Executive Board approved and published the Belgian FSAP report, [5] together with technical notes on specific topics. The report contained a series of recommendations, with a deadline for implementation, and mentioned the authorities to which they were addressed (the Bank, the FSMA or the federal authorities). Although non-binding, the IMF's recommendations nonetheless carry considerable weight. In its analysis, the IMF noted that most of the recommendations addressed to the Bank in the 2017 FSAP had been implemented. These included the integration of bank stress tests into the systemic risk assessment, the development of a framework to analyse non-bank financial intermediation and measures to improve the quality of insurers' capital and reduce their liquidity risks. The macroprudential policy toolkit has also been strengthened through the introduction of prudential expectations for new mortgage lending. The IMF also outlined areas where there is still room for improvement in implementation of the 2017 recommendations, namely strengthening of the Bank's macroprudential powers, enhancing its regulatory and supervisory powers over Swift, [6] and certain aspects of bank resolution and crisis preparedness.

In its report, the IMF noted that the Belgian financial sector has proved resilient in recent years to a series of shocks, such as the pandemic and Russia's invasion of Ukraine, and remains well capitalised and profitable. The solvency stress tests conducted by the IMF in cooperation with the Bank and the ECB showed that the country's major credit institutions are capable of absorbing materialised credit and market risks resulting from a severe deterioration in the macrofinancial situation. According to the IMF, this resilience was due to banks' good position at the start of the test and their interest margin, supported by the sharp increase in the base rate in the tested

1 Euroclear Bank, established in Belgium, is an international custody and settlement institution for debt securities, equities and investment fund shares.
2 Committee on Payments and Market Infrastructures.
3 International Organization of Securities Commissions.
4 Published in 2012 by the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO), these principles establish international standards for market infrastructures aimed at promoting financial stability by regulating payment, settlement and clearing systems.
5 IMF, Belgium: Financial Sector Assessment Program-Financial System Stability Assessment (imf.org), December 2023.
6 Established in Belgium, Swift is the main messaging system used by banks and other financial institutions worldwide.

scenario. In addition, the stress tests demonstrated that the liquidity level of the Belgian banking system would remain comfortable in a crisis situation, due to access to a broad deposit base, while its solvency would be only moderately affected by a shock that necessitated the liquidation of assets held at amortised cost. However, the IMF pointed out that both its solvency and liquidity stress tests revealed differences between the individual results of major credit institutions. This led the IMF to recommend that the Bank continue to develop advanced models for the monitoring of credit and ALM risk, [1] ensuring that these are integrated into its macroprudential policy framework in order to provide a comprehensive impact analysis on the level of profitability and solvency of Belgian banks. The results of the various banking stress tests conducted by the IMF confirmed those of tests conducted earlier in 2023 by the EBA, [2] even though the exercises are not necessarily comparable in terms of the scenarios and methodology used.

According to the IMF, non-bank financial intermediaries are also resilient to an adverse shock. The solvency stress test for insurance companies showed that the sector is capable of withstanding a severe shock, although there is room to improve its capital quality and pockets of risk are present, particularly with regard to property exposures. The FSAP also analysed the ability of insurance companies to withstand liquidity shocks. Low exposure to derivatives renders these companies largely resilient to margin calls following a rise in interest rates. Similarly, the insurance sector generally has sufficient liquidity to cope with large redemptions, although the results are scattered. The IMF nevertheless recommends that the Bank continue to implement liquidity stress tests and scenario analyses to identify sources of vulnerability. The liquidity stress test for the investment fund sector also revealed that it would be largely capable of withstanding severe but plausible redemption shocks. Finally, an interconnectedness analysis illustrated that, while domestic interbank links are limited, Belgian banks are nonetheless substantially exposed to foreign non-financial sectors.

Despite an overall favourable assessment of the health of the Belgian financial sector, the IMF report mentioned a number of challenges. Firstly, the IMF identified cyclical vulnerabilities linked to the current inflationary environment and the tightening of credit conditions, which have slowed economic activity. As with the previous FSAP, the IMF also called for a strengthening of the Bank's capacity to implement macroprudential measures within an acceptable timeframe. In this respect, the FSAP report recommends that the macroprudential tools enshrined in the CRR/CRD [3] [4] no longer be formally approved by the government, while maintaining a consultative role for the finance minister. Finally, the IMF considers the "twin peaks" supervisory model [5] to be a success, but sees opportunities to intensify cooperation between the Bank and the FSMA, particularly in terms of data and information exchange.

As in 2017, the 2023 FSAP also looked at the development of the banking union. In the IMF's view, the increasing emphasis on capital and liquidity requirements at the level of euro area banking groups is likely to be accompanied by lower requirements at the level of the systemically important subsidiaries of these groups. In the case of Belgium, this is important because a number of subsidiaries of foreign banking groups occupy an important position in the country's financial sector. To this end, the IMF reiterated that, during the transition period prior to completion of the banking union, it is essential for these subsidiaries to maintain sufficient capital and liquidity buffers.

The IMF noted the effectiveness of supervision of the Belgian financial sector and of financial crisis management in Belgium by the authorities concerned, but encourages further measures in this area. In particular, it suggests continuing efforts to strengthen the governance rules of institutions subject to the Bank's supervision, in particular the supervisory role of non-executive directors and, more specifically, independent directors. With regard to smaller credit institutions, it recommends developing a more systematic approach to monitoring their internal capital targets and incorporating information

1 Asset-liability management.
2 EBA, EBA publishes the results of its 2023 EU-wide stress test | European Banking Authority (europa.eu), July 2023.
3 Capital Requirements Regulation (CRR).
4 Capital Requirements Directive (CRD).
5 Established in the wake of the 2007-2008 global financial crisis, the so-called "twin peaks" model entrusts the Bank with responsibility for maintaining the micro- and macroeconomic stability of the financial system and the FSMA with responsibility for ensuring the proper functioning, transparency and integrity of the financial markets.

on bank conduct and consumer protection into the SREP.[1]

With regard to crisis management strategy and the financial safety net, the IMF acknowledged that the competent authorities have made significant progress since the last FSAP, particularly with regard to the preparation of resolution plans and the strengthening of loss absorption and recapitalisation capacity (minimum requirement for own funds and eligible liabilities or MREL). In the IMF's view, recent cases of intervention in troubled banks demonstrate the need to maintain sufficient flexibility to resolve problems, not least because institutions that are not identified a priori as being of systemic importance can still have an impact on the stability of the national financial system if they default in specific circumstances. In addition, recent cases have shown that it is essential for institutions to have sufficient liquidity before and during resolution. In this regard, the IMF recommended focusing on ensuring that resolution plans are operational, developing resolution tools that are not part of the preferred resolution strategy, and strengthening the framework for emergency liquidity support. The IMF also stressed the importance of internal and external coordination and cooperation on crisis management and financial safety net strategies. Finally, the IMF made a series of recommendations relating to the deposit guarantee scheme, such as the development of an investment policy in line with international best practice.

In the IMF's view, the current regulatory and supervisory framework for the Belgian insurance sector is well developed. However, regulatory changes are in the pipeline, such as the revision of the Solvency II Directive, the introduction of the Insurance Recovery and Resolution Directive (IRRD) and the implementation of the Digital Operational Resilience Act (DORA). The IMF stresses that the Bank needs to assess the impact of these forthcoming changes on the Belgian regulatory and supervisory framework applicable to insurance and reinsurance undertakings, particularly in terms of the staffing and skills required for effective supervision. These changes to the European regulatory framework will also have an impact on the insurance sector, which is already facing a difficult macroeconomic environment characterised by volatile financial markets, rising interest rates and persistently high inflation. In addition, the sector is exposed to new emerging risks, including climate-related risks, sustainability risks and risks associated with cyber-attacks. The Bank must ensure that the insurance sector is adequately prepared to cope with this challenging and changing environment.

The IMF noted a number of changes in insurers' investment portfolios that are also linked to changes in the macroeconomic environment. For example, exposure to real estate and mortgages has increased slightly in recent years. The increase in investments in this type of asset is a point of attention for prudential supervision, for both the banking and insurance sectors. The IMF therefore recommends that the Bank continue to pay attention to these asset classes and publish guidelines to promote consistency in the valuation of mortgage loans between insurers.

In the area of anti-money laundering and combating the financing of terrorism (AML/CFT), the IMF praised the substantial progress made by the Bank in extending its risk-based monitoring. In its recommendations, the IMF calls on the Bank to allocate additional resources to monitoring the fight against money laundering and the financing of terrorism, to pay greater attention to the financing of terrorism, to strengthen the implementation of the sanctions framework and, finally, to continue enhanced oversight of the payment institutions sector.

Finally, the IMF concluded that Euroclear Bank, which plays an essential role in the provision of services to the financial markets, has a sound legal basis and is subject to effective supervision by the Bank and the FSMA. The recommendations focused mainly on strengthening the IT risk management framework, given constantly evolving cybersecurity risks, and improving the testing of procedures to ensure business continuity in the event of a crisis or the resolution of a defaulting participant.

More information on the IMF's analysis and recommendations can be found in the FSAP report and its technical annexes. These recommendations will have an impact on the programme of the authorities concerned, more specifically the Bank, in the coming years.

1 The Supervisory Review and Evaluation Process (SREP) is a global review carried out on an annual basis, the primary objective of which is to ensure not only that banks have adequate levels of capital and liquidity but also that they have appropriate governance mechanisms, strategies and internal processes to enable them to manage and hedge their risks adequately.

4. Interest rates on savings accounts and life insurance

As the authority responsible for maintaining the stability of the Belgian financial sector, the Bank issued reasoned opinions during the year under review on the minimum interest rate applicable to regulated savings accounts and on the maximum interest rate for new individual or group life insurance policies.

4.1 Interest rates on regulated savings accounts

During the year under review, at the request of the finance minister, the Bank issued reasoned opinions on several draft laws aimed at amending the statutory framework governing regulated savings accounts. On 2 June of the year under review, the Bank issued a reasoned opinion on two draft laws tying savings rates to the European Central Bank's deposit facility rate, which would oblige banks to offer a higher base rate and a loyalty bonus (or "fidelity premium") on regulated savings accounts. This opinion [1] was explained to the Finance and Budget Committee of the House of Representatives on 20 June. On 13 July, the Bank issued additional opinions on a third draft law that proposed partially linking the interest rate on savings accounts to the interest rate on Belgian government bonds and on a modified version of one of the first two draft laws. At the request of the finance minister, the Bank submitted the three legislative proposals to the European Central Bank, which issued its opinion [2] on 28 June.

In order to encourage the transmission of market interest rates to the rates applicable to Belgian regulated savings accounts, the three proposals tie the minimum interest on savings accounts to the European Central Bank's deposit facility rate or the 10-year OLO rate. Two of the three bills stipulate that the minimum base rate may not be lower than the ECB rate less two percentage points. The third provides that the minimum base rate may not be lower than the 10-year OLO rate, but only for an initial tranche of € 10 000 per saver. At the request of the finance minister, the Bank also issued an opinion on a revised version – for an initial tranche of € 25 000, € 50 000 or € 100 000 – of one of the two proposed laws tying the base rate to the ECB rate.

The Bank based its opinions on an assessment of the consequences of and potential risks posed by these legislative proposals for the stability of individual financial institutions and the Belgian financial sector as a whole. It also took into account undesirable side effects on the volume and/or nature of lending to Belgian households and businesses, for which savings accounts constitute an important source of stable funding. More specifically, it took into account the following key elements.

Regulated savings accounts represent around a quarter of the balance sheet total of the Belgian banking sector. However, the degree of dependence on this source of funding varies greatly from bank to bank, depending on the business model. For banks whose business model focuses on financial services to Belgian households and businesses, a large proportion of the balance sheet is generally financed by regulated savings accounts. For banks focusing on retail customers (savings banks), this proportion often exceeds 50 %. These institutions are therefore particularly sensitive to a significant short-term increase in the cost of this source of financing.

Due to their volume and stability, regulated savings accounts constitute an important source of financing for loans to Belgian households and businesses. In Belgium, these loans are mainly granted by banks, which convert customer deposits into loans. This process involves credit, interest rate and liquidity risks, which banks must manage carefully and, where necessary, hedge, in order to ensure their financial stability. These risks also form the object of prudential regulation and supervision to ensure that banks do not take excessive risks in this area. Overall, maintaining the stability of these deposits is important both for the health of financial intermediation in Belgium and for the stability of the Belgian financial system. Thus, to ensure financial stability, the Bank defended maintaining the statutory minimum remuneration (0.01 % base rate and 0.10 % loyalty bonus) in a context of low or even negative interest rates.

In a period of rising interest rates, banks need to manage their interest rate risk carefully, given the increasing cost of funding. A large

1 Opinion on the proposed legislation concerning savings accounts, 2 June 2023.

2 ECB Opinion of 28 June 2023 on tying the minimum base interest rate on regulated savings accounts to the deposit facility rate and introducing a protected interest rate on savings deposits (CON/2023/18).

proportion of Belgian banks' funding comes from the current and savings deposits of households and businesses. When the interest rate on these accounts is adjusted, it applies to the total amount outstanding. Traditionally, a large proportion of sight deposits generate little or no interest, while interest on savings accounts generally follows market conditions with a lag and in stages, as market rates rise and fall. The rise in market interest rates has enabled banks to increase the interest they pay on these deposits. However, in doing so, banks must consider the development of income from all interest-bearing assets (including hedging transactions), part of which is generated by assets with interest rates that have been fixed for a long period in a low interest rate environment, as is the case with mortgages. At the end of 2022, around three-quarters of Belgian mortgage loans had a fixed interest rate for their entire term. The average yield on these loans was still below 2 %, due to the origination of low-interest-rate loans in recent years and the refinancing of older loans at lower interest rates. Moreover, variable-rate loans are subject to a statutory ceiling in Belgium (the rate can never be more than twice the initial rate). Unlike regulated savings accounts, to which an interest rate adjustment applies immediately to the entire amount outstanding, the average yield on a mortgage loan portfolio adjusts only gradually to new interest rate conditions. Thus, for many assets held by Belgian banks, the yield increases only gradually.

With a return on equity of 12.5 % for the first nine months of 2023 and 10 % in 2022, the Belgian banking sector (with the exception of infrastructure banks) recorded very high, albeit not excessive, profits over the past two years. This profitability was more than sufficient to allow for a market-conform return on equity. Such market-conform remuneration is necessary to guarantee good access to the capital markets for banks obliged to raise additional funds. It also ensures that shareholders will support the organic growth of the balance sheet in line with the demand for credit in the economy. Low profitability or losses can weaken a bank's financial position and undermine the confidence of depositors and other creditors.

Compared with the increase in the profitability of Belgian banks in 2023 and the trend in interest rates on savings accounts in other countries, the return on Belgian savings accounts rose more slowly than expected during the year under review (see also chapter 7 in the "Economic and financial developments" section of this report). According to the ECB's harmonised statistics, in November 2023, Belgian banks paid an average savings rate (including the loyalty bonus) of 0.62 %, an increase of 0.5 percentage points compared with the end of 2022 (0.09 %). Based on the past transmission of market rates to the savings rate, the latter (including the loyalty bonus) should have been,

over the first eleven months of the year, on average 0.45 percentage points higher than reported.

When publishing its 2022 annual report in March 2023, the Bank indicated that banks had room to increase the interest rate on savings accounts. Indeed, to preserve the stability of deposits as a source of financing for the Belgian banking sector, it is preferable to keep interest rates in line with changes in market conditions. Otherwise, banks run the risk of seeing a portion of this stable source of funding, and ultimately for lending to Belgian households and businesses, channeled to other investments. In this context, the Bank's governor also noted that if the remuneration on savings accounts was not gradually raised, this would indicate a structural competition problem. In June 2023, attention was again drawn to these two issues.

Tying the minimum remuneration on savings accounts to an external reference rate, as provided for by the aforementioned legislative proposals, would generate risks for financial stability and significant undesirable side effects. The indicated reference rate (the ECB deposit facility rate or the 10-year OLO rate) is not a correct measure of the change in the average return on assets of Belgian banks or of the difference between the return on assets and the return on liabilities (the interest margin). These parameters are essential to determine the extent to which interest rates on savings accounts can be increased without threatening the sustainable profitability and stability of individual financial institutions or the Belgian financial system. Thus, in their calibration of the targeted regulatory minimum interest rate, the legislative proposals largely ignore the impact of savings account rate adjustments on bank profitability. Small and medium-sized savings banks in particular, which hold a relatively large proportion of savings accounts and mortgages on their balance sheet and for which savings accounts constitute an important hedge against the interest rate risk associated with fixed-rate mortgages, are likely to suffer significant losses if the gradual transition to higher interest rates on savings accounts were to give way to government intervention resulting in an accelerated and sudden increase in the savings rate. In addition, tying the savings rate to the yield on Belgian government bonds risks triggering a vicious circle (a "doom loop") between the government's financing costs and those of the banking sector in the event of tensions on the Belgian government bond market. Other undesirable side effects are related to the central role played by savings accounts in financing loans to Belgian households and businesses and in managing interest rate risk. A sudden, sharp increase in the remuneration of savings accounts can be expected to result in higher rates for loans to households and businesses. In addition, intervention in the pricing of savings accounts could hinder the financing of fixed-rate loans in the future. As savings accounts play an essential role in banks' interest rate risk management (see chapter 7 in the "Economic and financial developments" section of this report), the proposed measures would also complicate risk management by banks. Poor management of interest rate risk poses a threat to financial stability, and in this way the authorities would be intervening de facto in areas primarily entrusted to the Bank, but without having to bear responsibility.

A revised application of the proposals to a first tranche of savings account balances would mitigate the risks outlined above, but would require fully effective control of compliance with the condition that this first tranche be limited to a single account per person. Without such a control mechanism, there is a risk that a large share of outstanding savings accounts would in fact be remunerated at the higher minimum interest rate, thereby jeopardising financial stability.

During the year under review, the Bank also took note of a report by the Belgian Competition Authority. This report proposes a number of ways to strengthen competition on the Belgian savings market.

4.2 Maximum interest rate on individual or group life insurance

On 24 April 2023, the minister for the economy requested the Bank's opinion on the maximum interest rate applicable to life insurance policies. More specifically, the question concerned the advisability of raising this rate in view of the rise in interest rates on the financial markets. Article 216 of the Insurance Supervision Act limits the return that insurance companies can grant on individual and group life insurance policies with a term of more than eight years. This rate is set, based on an opinion issued by the Bank, on 1 January of each year. For 2024, the rate is 2 %. Given the recent rise in

market interest rates, a question was raised, by both the sector and the government, of the possibility of setting a higher maximum rate, if applicable by amending the aforementioned Article 216.

When consulted on this subject, the Bank recommended a degree of caution. On the one hand, while the rise in interest rates is currently a very real phenomenon, there is no guarantee that it will not change course over the next few years, particularly given the current geopolitical context. Furthermore, the guaranteed rate on a life insurance policy differs fundamentally from the return on other financial products in that it is guaranteed for a very long period and cannot be changed by the insurance company. The prudential supervisory authority has few means at its disposal of reducing rates, if they put the solvency of an insurance company at risk. In fact, such a possibility only exists in the event of the liquidation of a company in bankruptcy or close to bankruptcy. It should also be noted, firstly, that if the maximum rate is changed, insurance companies can only apply it to new contracts. The change has no effect on existing policies. Secondly, the maximum rate does not apply to contracts with a maximum term of eight years. For such contracts, companies may guarantee rates in excess of the maximum set further to Article 216, provided the maturity and yield of their assets so allow.

5. Prevention of money laundering and terrorist financing

The Bank verifies that financial institutions comply with their statutory obligations regarding the prevention of money laundering and terrorist financing. Financial institutions must have a good understanding of their risk profile with regard to money laundering and terrorist financing, as well as the risk profile and transactions of their customers. They must report suspicious transactions to the Financial Intelligence Processing Unit. In 2023, the Bank further strengthened its monitoring of anti-money laundering and combating the financing of terrorism (AML/CFT) compliance. It updated its AML/CFT risk analysis for the Belgian financial sector and carried out thematic actions, particularly in the areas of de-risking and the activities of money remitters. Finally, as part of its regular monitoring, the Bank imposed administrative measures and sanctions for serious violations of the legislation on money laundering and the financing of terrorism.

The Bank resumed active participation in national and international policy discussions within the EBA, the Financial Action Task Force (FATF) and the BCBS in 2023, as well as in European negotiations on the AML/CFT legislative package.[1] Negotiations on the AML/CFT package entered a decisive phase in 2023. If all goes according to plan, the EU will soon have its own AML/CFT authority and a single rulebook.

5.1 The Bank updated the AML/CFT risk analysis for the financial sector

The AML/CFT risk landscape is constantly evolving, including in Belgium. As a supervisory authority, the Bank must remain alert to new risks.

In its assessment, the Bank analysed a series of cross-cutting AML/CFT risks, such as Russia's invasion of Ukraine and drug trafficking in the port of Antwerp. It also assessed the risk inherent in each type of financial service and the measures that can be taken to mitigate it.

A similar analysis is underway at European level. In 2023, the EBA carried out an AML/CFT assessment for the European financial sector, and the European Commission published an AML/CFT assessment for the European economy and society as a whole. These analyses are available on the Bank's AML/CFT webpage.[2]

5.2 AML/CFT monitoring trends in Belgium

The Bank stepped up the fight against de-risking

AML/CFT is sometimes used as a pretext for refusing (potential) customers access to a bank account. Instead of identifying the customer's specific AML/CFT risk and applying enhanced due diligence measures, banks sometimes refuse to open an account or terminate the relationship with the customer simply because the latter belongs to a higher-risk group. Examples include Belgians abroad, embassies

1 Anti-money laundering and countering the financing of terrorism legislative package (europa.eu).
2 Risk-based approach and overall risk assessment | nbb.be.

and NGOs. These cases pose a problem for financial inclusion. To address this issue, the Bank published a circular on 1 February 2022 setting out its expectations in this area.[1] The Bank strives for a careful balance. On the one hand, banks have freedom of contract in implementing their customer acceptance policy. On the other hand, they may not refuse customers on AML/CFT grounds that are not provided for by law. In 2023, the Bank carried out targeted inspections of banks to verify compliance with this circular. The Bank will continue to pay attention to this socially important issue in 2024. If there are serious indications of risk-taking, it will question the financial institution in question. However, the Bank cannot intervene in the relationship between the institution and its customer. If customers wish to seek mediation, they can turn to Ombudsfin.[2]

Focus on money remitters and their agents

The money remittance sector has grown steadily in Belgium in recent years, in both number and size. Money remitters are payment institutions that carry out money transfers. For Belgians with family abroad, money remittances are often an inexpensive way of sending cash. In some countries with a large diaspora, the funds sent in this way make a significant contribution to gross domestic product. Naturally, money remittances carry AML/CFT risks. For example, customers often bring cash with them to transfer funds. In addition, money remitters often do not know their customers very well, since it is not necessary to open an account and transactions are generally only occasional. Moreover, the funds are often sent to higher-risk countries.

Many money remitters rely on local agents, such as night shops. These agents therefore play a crucial role in the front-line monitoring of customers and their transfers. In 2023, the Bank conducted a horizontal analysis of money remitters in Belgium and the tied agents of selected remitters. The Bank focused on the monitoring by money remitters of their agents, the quality of customer identification data, due diligence measures with regard to high-risk customers and the identification of atypical facts and transactions. This analysis was successful, and the Bank used the findings to publish a set of best practices and points for attention on its AML/CFT webpage.[3]

1 Circular NBB_2022_03 / Prudential expectations in relation to "de-risking" | nbb.be.

Sanctions screening

Financial institutions must be able to guarantee that they do not carry out transactions with counterparties appearing on a Belgian, European or international sanctions list, by relying on effective screening of their transactions. To do so, they must have an appropriate organisation. In order to fulfil this screening obligation as effectively as possible, Febelfin drew up a multilateral outsourcing agreement in close cooperation with the Bank. Banks that adhere to this agreement will be able to rely on screening of domestic transactions carried out by another bank that is party to the agreement. The agreement entered into force in January 2024. Adherence to the agreement will be considered by the Bank as a positive factor in its assessment of the adequacy of the organisation with regard to sanctions screening for domestic transactions.

Focus on current events

The Bank is occasionally informed by the press or whistleblowers of cases of money laundering or terrorist financing involving Belgian financial institutions. If the indications are serious, the Bank conducts an investigation. These external sources help the Bank monitor compliance by financial institutions with their AML/CFT obligations. A recent example is Qatargate, the alleged corruption scandal within the European Parliament.

5.3 The Bank participated in the AML/CFT colleges

Many financial institutions are active in several countries. Cooperation and the exchange of information between AML/CFT supervisors is therefore essential. In 2019,[4] the EU laid the foundations for AML/CFT colleges, which regularly gather together the national AML/CFT supervisory authorities for a given financial group. The Bank is convinced of the added value of these colleges. In 2023, it was the

2 See https://www.ombudsfin.be.

3 Communication NBB_2023_08 – Horizontal analysis of a sample of transactions carried out through tied agents of various payment institutions https://www.nbb.be/doc/cp/fr/2023/nbb_2023_08_communication_fr.pdf

4 EBA report on the functioning of anti-money laundering and counter-terrorist financing colleges in 2022 (10 August 2023).

lead supervisor in 13 colleges and participated in 42 colleges for financial institutions active in Belgium. Last year, the EBA published a report on the functioning of AML/CFT colleges in the EU, identifying good practices and points of interest which are also informative for the Bank.

5.4 The Bank imposed administrative measures and sanctions

Where financial institutions fail to comply with their statutory AML/CFT obligations, the Bank may impose administrative measures to remedy the non-compliance. These measures may be published. For example, on 16 November 2022, the Bank made public an administrative measure it had imposed on an electronic money institution. The Bank's inspections had revealed serious AML/CFT shortcomings in the institution's organisation and internal controls. The Bank therefore imposed a deadline for the institution to remedy these failings.

The Bank's Sanctions Committee can also fine institutions that fail to comply with their AML/CFT obligations. For example, on 2 June 2023, the Sanctions Committee imposed a fine of € 15 million on a bank for failure to comply with the AML/CFT legislation.[1]

For the Bank, these administrative measures and sanctions are an essential part of effective supervision. Consequently, the Bank will continue to use these means when necessary. International institutions, such as the EBA and the IMF, encourage the Bank to continue in this direction.

5.5 The Bank contributed to the drafting of new regulations and issued guidelines

The Bank's AML/CFT webpage

The Bank continued its ongoing work to consolidate, in a dedicated section of its website, relevant texts and to clarify the comments and recommendations and corresponding expectations of the Bank with regard to the financial institutions under its supervision.

Among other updates, all presented chronologically on its website, the Bank drew the attention of institutions to the EBA's report on the risks associated with payment institutions. The Bank also drew the attention of financial institutions to the publication by the European Commission of a single list of prominent public functions at national level, the level of international organisations, and the level of the European Union institutions and bodies. The Bank's expectations, based on EBA guidelines, for the role and responsibilities of the AML compliance officer and the senior executive responsible for AML/CFT, as well as the EBA guidelines on remote customer onboarding solutions, also formed the object of new publications on its website.

Electronic transfers

The Bank is taking part in work to modernise FATF Recommendation 16 on wire transfers, in order to take into account far-reaching developments that have changed the way funds are transferred worldwide. This work, on which the FATF will consult the public, should be completed in 2024.

The European Banking Authority

Also in 2023, the Bank actively participated in discussions between AML/CFT supervisors within the EBA's AML Standing Committee, chaired by a representative of the Bank. In 2023, the EBA published guidelines on a wide range of subjects which are applicable to the Belgian financial sector. Please refer to the EBA's annual report for more information.[2]

5.6 The Bank is preparing for a European AML/CFT authority

Negotiations on the creation of a European AML/CFT authority and the drafting of a single European rulebook reached the final stage. This authority (the Anti-Money Laundering Authority or AMLA) will be responsible for the direct AML/CFT supervision of a limited number of European financial institutions, as well as for the indirect supervision of other institutions. It will represent a true paradigm shift for AML/CFT supervision in Europe.

Once the Council and the European Parliament had adopted their respective positions, so-called trilogue

1 Decision of the Sanctions Committee of the National Bank of Belgium of 2 June 2023 (only available in Dutch).
2 Annual Reports | European Banking Authority (europa.eu).

negotiations between the Parliament, the Council and the Commission began under the Swedish Presidency and continued under the Spanish Presidency. In January 2024, work continued and the negotiations were concluded under the Belgian Presidency. The Bank played an important role in these negotiations. The agreement remains "provisional" until the – Council and the European Parliament formally confirm the text, which is expected to occur during the current legislative term.

To prepare for this new reality, the Bank is actively involved in discussions within the EBA on the transition to AMLA and the impact of AMLA on AML/CFT supervision.

5.7 The Bank is preparing for an FATF evaluation

As part of a mutual evaluation, the FATF will assess in 2024-25 how Belgium is fighting money laundering, terrorist financing and the proliferation of weapons of mass destruction. In doing so, the FATF will examine both the extent to which the Belgian regulatory framework addresses its 40 recommendations and the effectiveness of the AML/CFT framework in Belgium. As the AML/CFT supervisor for a large part of the financial sector, the Bank will be a key interlocutor for the FATF in this regard. The FATF will also hold direct discussions with financial sector representatives. Following its assessment, the FATF will publish a report on Belgium. The last FATF assessment dates back to 2014-15. Since then, the Bank's internal organisation, supervision methodology and AML/CFT controls have undergone profound changes. At the same time, the Bank's resources (both in terms of staff and IT tools) have also increased substantially. In addition to the FATF assessment, the Bank's AML/CFT controls also formed the object of a limited review by the IMF in 2023 as part of the Financial Sector Assessment Program (FSAP) (see section B.3).

6. Climate-related and environmental risks

In 2023, the Bank continued to pay particular attention to climate-related and environmental risks. Climate change and environmental degradation give rise to economic costs and financial losses, and therefore potentially significant risks to financial stability. A distinction can be made between physical risks and transition risks. While physical risks are linked to the occurrence of extreme and/or chronic climate events, transition risks stem from the costs associated with the necessary transition to a more sustainable, low-carbon economy. The first part of this section deals with the monitoring of climate-related and environmental risks identified by the Bank as being significant for the Belgian financial system, namely transition risks in the real estate sector. This section is supplemented by a short box dealing with another major risk affecting the Belgian insurance sector, namely the natural catastrophe insurance gap. The next three sections examine the main developments relating to the three pillars of the prudential framework. Finally, the last part looks at the issue of transition plans in the prudential framework.

6.1 Energy efficiency of real estate exposures

Transition risk related to real estate exposures has long been considered the main climate-related risk for Belgian banks, due to the high emissions of the Belgian building stock and high real estate exposure. The Bank therefore issued a circular in 2020[1] asking banks and insurers to gather information on the energy efficiency (in the form of EPC data)[2] of the properties backing new mortgages and to report these data from 2021 onwards. The circular also explicitly urges banks to take energy efficiency into account in their internal risk management.

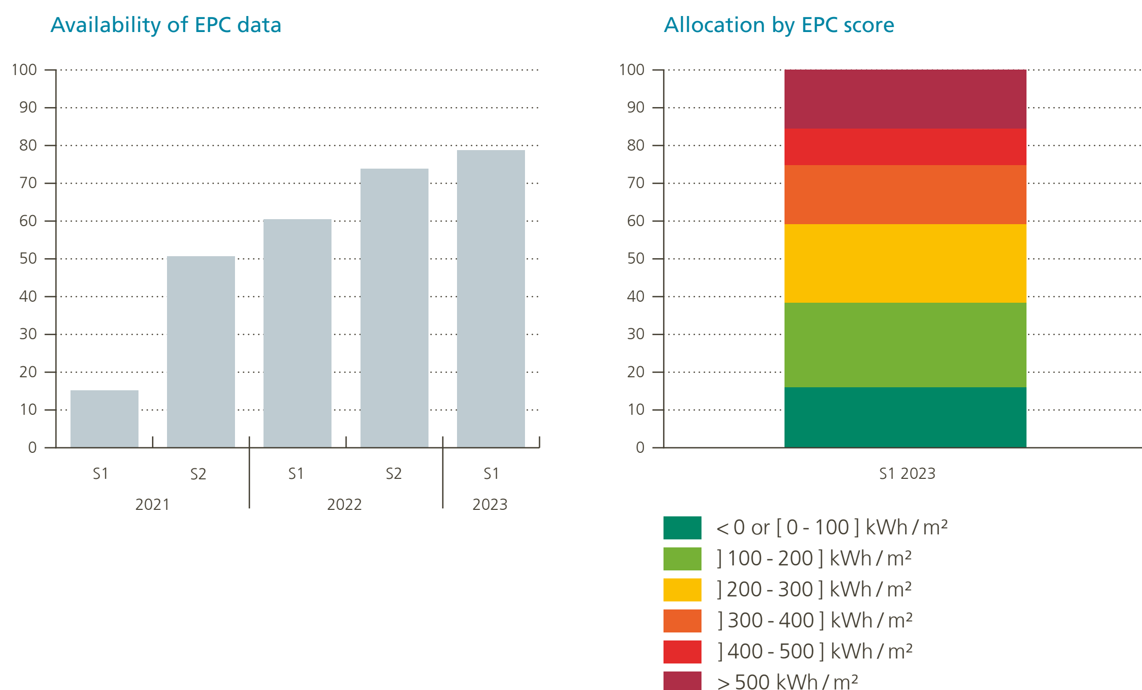
The fact that banks have made significantly more data available since the start of this reporting exercise shows that they, too, recognise the importance of energy efficiency in the context of transition risk management. This appears from the left-hand chart in Figure 1. During the year under review, however, the Bank informed the banking sector of improvements that could still be made in the analysis and management of this risk.[3] In its feedback, the Bank reiterated its support for the banking sector's efforts to gain access to regional EPC databases. The right-hand chart shows the allocation of mortgages

1 Circular NBB_2020_45 / Collection and reporting of information on the energy efficiency of property exposures.
2 Energy performance certificate
3 Feedback to the banking sector of 11 May 2023.

Figure B.1

EPC data for new loans

(as a % of total new loans)



Source: NBB.

by EPC score.[1] This chart reveals that around 40 % of mortgages granted in the first half of 2023 were for relatively energy-efficient homes, while a third were for very energy-efficient dwellings. The transition risk for these homes could be extremely high. On the one hand, borrowers could find it difficult to repay their mortgage due to rising energy costs. On the other hand, following the adoption of climate policies, borrowers could be obliged to make (costly) investments to reduce emissions in order to obtain a "better" EPC rating for their property. Borrowers that did not take these factors into account when taking out a mortgage could find their ability to repay the loan compromised.

In addition, current reporting shows that there is a negative relationship between the creditworthiness of borrowers and the energy efficiency of the mortgaged property. The percentage of borrowers with a high loan-to-value ratio (namely, the ratio of the amount borrowed to the value of the property) is significantly higher for properties with poorer EPC ratings at the time of purchase. Banks are therefore faced with a twofold vulnerability for this type of borrower. When energy prices rise or mandatory investments have to be made to make a home more energy-efficient, these borrowers are more likely to encounter problems.

According to the Bank's analyses, it turns out that a significant proportion of the mortgage loans granted for energy-inefficient properties will be used specifically for renovation, which mitigates the transition risk somewhat. Moreover, the value of the mortgaged property will improve over time if an energy renovation is carried out. This also has a positive impact on the loan-to-value ratio and the risk for banks. The EPC reporting on new mortgages required by the abovementioned circular will be adapted and refined in 2024, to give the Bank more insight into this type of loan. The increased availability of these certificates has probably helped reduce the transition risk associated with Belgian homes, since the higher price difference between energy-efficient and energy-inefficient homes seems to correspond to the average cost of a thorough energy renovation for the latter.

1 An energy performance certificate (EPC) provides an estimate of the energy consumption of a dwelling, expressed in kWh/m². The EPC classification used is that applied in Flanders.

BOX 1

Natural disaster insurance

The floods that occurred in July 2021 caused a great deal of human and financial suffering for Belgian households and businesses. The impact was also very significant for the insurance industry, as water damage to buildings is covered by fire insurance.

The inclusion of flood cover in fire insurance had already been made compulsory to protect policyholders against damage caused by natural disasters. In addition, in order to guarantee the insurability of flood damage and the financial stability of the insurance sector, the legislature had previously also developed a specific scheme as part of a public-private partnership. Under this arrangement, an initial tranche of the financial loss in the event of flooding is borne by insurance companies. For exceptional disasters, coverage is capped, and the regions step in to cover the remainder of the damage suffered by Belgian households.

At the time of the floods in July 2021, this cap was set at € 350 million. However, the total damage caused by the floods reached € 2.4 billion. The insurance sector therefore decided, by mutual agreement with the regions, to more than double its contribution compared with the statutory limit. This increased the share of losses borne by insurance and reinsurance companies.

However, more than two years after the floods, it should be noted that there is still no new stable statutory framework defining unambiguously how the burden of claims resulting from future natural disasters will be shared. This situation and the resulting uncertainty have already had a significant impact on Belgian insurers. Some companies are having difficulty obtaining reinsurance for natural catastrophe risks. In general, the premiums charged by reinsurers to Belgian fire insurers have risen by 50 %-60 % over the last two years. If this situation continues, reinsurers risk scaling back their business in Belgium. As a result, insurance companies would no longer be able to offer cover, and Belgian households would no longer be able to insure themselves against fire and natural disasters or would only be able to do so at much higher premiums.

To provide greater certainty for all stakeholders, a clear statutory framework should be put in place. An initial reform of the law has already been carried out, raising the ceiling to € 1.6 billion. However, the Bank believes that a new, more fundamental reform is needed to clarify allocation of the costs of future natural disasters in Belgium, the financing of regional calamity funds, and the soundness of the framework in the light of worsening floods and other natural disasters.

6.2 Pillar 3 disclosures

At European level, the Pillar 3 disclosure requirements for environmental, social and governance-related risks (ESG risks) became effective in 2023, for financial year 2022, for large credit institutions issuing listed securities. These disclosures cover quantitative information on transition risks and physical risks associated with climate change, including data on exposure to sectors with high carbon emissions and assets subject to the impact of extreme weather events. They also include quantitative information on the actions taken by credit institutions to support the businesses and households they lend to in the transition to a carbon-neutral economy and in adapting to climate change. Finally, qualitative information on how credit institutions integrate ESG considerations into their governance, business model, strategy and risk management framework is also disclosed.

The introduction of this type of reporting is an important step towards meeting a major challenge facing supervisory authorities in their efforts to assess climate-related and environmental risks adequately, namely the lack of consistent, comparable and reliable data at international level. This is a gradual reporting process, with the aim of moving towards the most comprehensive coverage possible. For example, for the 2023 financial year, institutions were required to disclosure figures indicating the proportion of their exposures considered, based on the European taxonomy, to be aligned with the EU's climate objectives. With the introduction of CRR3, these disclosure requirements will become applicable to all credit institutions, including those that do not issue listed securities.

In parallel with the work being carried out at European level, the Basel Committee continued to reflect on the implementation of Pillar 3 disclosure requirements for climate-related risks and published a consultation paper on this subject at the end of 2023.[1]

6.3 Inclusion of climate-related and environmental risks in prudential supervision

Climate-related and environmental risks are increasingly being integrated into banking supervision, and expectations for the inclusion of these risks by banks in their risk management are becoming more stringent. By March 2023, significant institutions (SIs) had to ensure that they adequately identify the climate-related and environmental risks to which they are exposed and analyse the impact of these risks on their business. By the end of 2023, they had to fully integrate these risks into their governance, strategy and risk management. Then, by the end of 2024, they must meet all the ECB's other expectations, set out in its November 2020 guide on the management and control of climate-related and environmental risks.[2] In 2022, the Bank asked less significant institutions (LSIs) to also meet these prudential expectations, albeit taking into account the nature, size and complexity of their activities. LSIs will also have an additional year to prepare. These prudential expectations are in line with the principles for effective management and control of climate change risks[3] published by the BCBS in 2022, and the EBA's 2021 report on the management and supervision of ESG risks.[4] Based on this report, the EBA also prepared a consultation paper in early 2024 providing guidance on ESG risk management.[5] The guidelines proposed by the EBA are very similar to the ECB and BCBS documents, but go further here and there and also include some recommendations for transition plans (see section B.6.5 of this report).

The ECB and the Bank are currently examining whether the shortcomings identified in relation to supervisory expectations are being adequately addressed and followed up. If this is not the case, the ECB may impose fines. In addition, the ECB is examining the possibility of imposing a Pillar 2 capital surcharge from 2024 onwards for increased exposure to climate-related and environmental risks. Finally, climate-related and environmental risks are increasingly integrated into inspections related to traditional risks such as credit, market and operational risks, and inspections are organised that specifically target climate-related and environmental risks.

1 BCBS, Consultative document on disclosure of climate-related financial risks (November 2023).
2 Guide on climate-related and environmental risks (europa.eu) (November 2020).
3 BCBS, Principles for the effective management and supervision of climate-related financial risks (June 2022).
4 EBA Report on management and supervision of ESG risks for credit institutions and investment firms (June 2021).
5 EBA Consultation paper, Draft Guidelines on the management of ESG risks (January 2024).

For the insurance sector, during the year under review the Bank carried out a cross-sectional analysis of the assessment of climate change risks reported by insurance undertakings in their internal risk and solvency assessments (*Own Risk and Solvency Assessment*, ORSA). The results show that the Bank's expectations in this respect, as set out in the ORSA circular,[1] are being met by the majority of insurance undertakings, although some of them need to develop their analyses further.

6.4 Capital requirements for climate-related and environmental risks

Climate-related and environmental risks must be taken into account when calculating minimum capital requirements for banks. Banks must ensure that they have sufficient capital buffers to absorb unexpected losses due to credit, market risk and operating risk. The higher the risk, the greater the buffer. As climate-related and environmental risk factors can influence traditional risks, it is important to check that they are properly taken into account. In this respect, the EBA published a report[2] in October 2023 containing a series of recommendations for banks and supervisory authorities. The report explains how capital requirement calculations can take account of climate-related and environmental risks, as well as social risks, in the short term, without having to make major adjustments to the regulatory framework. These recommendations are highly consistent with the "Frequently asked questions and answers on climate-related risks" published by the Basel Committee in December 2022,[3] but go further on a number of points. In addition, the EBA report contains a number of recommendations that can only be properly applied once more data is available or which will require effective adaptation of the regulatory framework. Some of the report's recommendations are therefore also addressed to the European Commission.

In any case, capital requirements must be based on risk calculations. Sustainable financing should be encouraged, but not by reducing the capital requirements for this type of financing as sustainable projects can be very risky. However, where it can be demonstrated that specific green exposures are less risky than their non-green equivalents, capital requirements for these exposures can and should be reduced. Conversely, this reasoning obviously also applies to exposures that are slightly more subject to climate-related or environmental risks. For these exposures, capital requirements should be increased. To encourage the transition to a more sustainable society, governments have much more effective measures at their disposal, from carbon taxes to subsidies for green investments. The Bank supports policies that give the financial sector a role in promoting the transition to a low-carbon economy. Indeed, by facilitating this transition, future risks can be reduced. In addition, certain business models that lack ambition in terms of sustainability may prove untenable in the long term. Such a lack of ambition can also lead to reputational risk if mandatory disclosures on climate-related and environmental risks and the management thereof reveal weaknesses in the institutions concerned and the market takes note. Helping sectors that are highly exposed to climate-related and environmental risks to become more sustainable, by providing them with the necessary financing, is very important to support the transition. However, it is also important that counterparties have a credible transition plan. Prudential regulation and supervision can help to facilitate the transition by ensuring that financial institutions adequately measure and manage ESG risks and take them into account in their business models and strategy, as well as in their corporate governance and risk appetite. This will not only strengthen their portfolios in the face of climate-related and environmental risks but also guide their business choices, financing and investments.

For the insurance sector, too, the Bank is keen to ensure that the risk parameters of the Solvency II standard formula take proper account of all risks to which insurance companies are exposed, including those linked to the effects of climate change. The Bank is participating in the work of the European Insurance and Occupational Pensions Authority (EIOPA) related to recalibrating the natural disaster risk parameters of the Solvency II standard formula to include the impact of climate change. The Bank sees this as an appropriate way of taking these risks into account under the first pillar. EIOPA is also continuing its analysis of the appropriateness of introducing differentiated treatment for assets that are substantially associated with environmental and/or

1 Circular NBB_2022_09 / Own Risk and Solvency Assessment (ORSA).
2 EBA Report on the role of environmental and social risks in the prudential framework (October 2023).
3 BCBS, Frequently asked questions on climate-related financial risks (December 2022).

social objectives. As part of this work, the Bank is also defending a risk-based approach based on solid data.

6.5 Transition plans

The interest shown in transition plans by regulators and supervisors, in addition to other stakeholders, has only increased recently. A distinction can be made between transition plans drawn up by banking institutions and those prepared by the companies to which they lend (hereinafter referred to as "counterparties"). These plans respond to the common need to have sufficiently forward-looking indicators capable of reflecting the high degree of uncertainty, the potentially longer time horizon and the nature of climate-related and environmental risks compared with other types of risk.

From a prudential point of view, it is important that banks' transition plans follow a sufficiently risk-based approach. Echoing this concern, it is confirmed that the update of European legislation to strengthen the resilience of the banking system (CRD6/CRR3) will incorporate the requirement for European banks to prepare prudential plans to address climate-related and environmental risks, including those arising from their misalignment with EU policy objectives.

In practice, updating the European legislation on prudential plans will help to improve the management and supervision of ESG risks under Pillar 2. This update is closely linked to the report published in June 2021 by the EBA on the subject,[1] which already recommended that credit institutions integrate ESG risks into their processes, in particular by extending the time horizon for strategic planning to at least 10 years and by testing their resilience to different scenarios. At the beginning of 2024, the EBA published a consultation paper on an update of this report, including more concrete details on what is expected of prudential plans (see also section B.6.3).

In addition, counterparty transition plans are a key source of information for those of banking institutions and the shift to a more granular forward-looking assessment of climate-related and environmental risks. In the future, doing business with counterparties engaged in environmentally harmful activities without taking account of their transition plans should no longer be considered compatible with sound risk management.

In this respect, the entry into force in 2024 of the Corporate Sustainability Reporting Directive (CSRD), which requires large companies and banks to report on sustainability in accordance with the European Sustainability Reporting Standards (ESRS), is particularly useful. This regulation includes an obligation for companies to disclose their plans to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with the EU's political objectives.[2]

The development and further formalisation of transition plans for banks and their counterparties are the subject of much discussion, and a number of questions remain unanswered for the time being. In addition to the content of these plans, unresolved issues include how to assess and guarantee their credibility and the role of supervisors in defining the objectives included in the plans, where applicable. There is also the question of how to integrate these plans into the three pillars of the prudential framework. These topics are the subject of discussion and exchanges of views not only at European level but also within the Basel Committee and the Network for Greening the Financial System.

7. Digitalisation

The digitalisation of financial services continued to grow in importance in 2023 and is enabling consumers, workers and businesses to meet a wide range of challenges. Examples of innovative developments include new business models based on payment solutions, the use of machine learning/deep learning technologies or robotic process automation to improve operational efficiency, the use of artificial intelligence and data analysis to refine business strategies, and the use of cloud services to manage IT infrastructures and aggregate data. These developments are often driven by the aim of anticipating the major changes expected in the structure of the financial services market. Indeed, the role of financial services and financial players is changing significantly worldwide. Integrated payment, e-commerce and social media platforms, as well as collaborative ecosystems, are increasingly being used for

1 EBA Report on management and supervision of ESG risks for credit institutions and investment firms (EBA/REP/2021/18).

2 Annex 1 to Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards.

both financial and non-financial services. In particular, innovation is facilitated by the use of modular technologies that allow different financial and non-financial players to communicate via interfaces.

All of these developments are already having a significant impact on the risks to financial institutions, consumers, monetary policy and/or financial stability. As digitalisation leads to greater interconnectivity, cyber security and the continuity of the underlying systems and infrastructures in particular are becoming increasingly crucial. The risks associated with digitalisation are likely to increase further in the foreseeable future. Against this background, the European Commission is taking a number of initiatives. Some of these are examined in this section, including those relating to operational resilience, payment services and artificial intelligence. The section also focuses on the Bank's initiatives to support the ECB's digital euro project, as well as efforts to map fintech/insurtech developments within supervised institutions.

7.1 The digital euro

The Bank, in cooperation with the ECB, is actively involved in preparing for the potential introduction of a digital euro. This project is currently in the preparatory phase, which began in November 2023 and will consist of two stages. The first stage will last at least two years with the aim of finalising a digital euro rulebook, to gain a better understanding of the necessary components of a future platform for digital euro services and to determine which (private or public) entities could develop these components. Subject to the approval of the ECB's Governing Council, the second stage of the preparatory phase will include the development and testing of this platform.

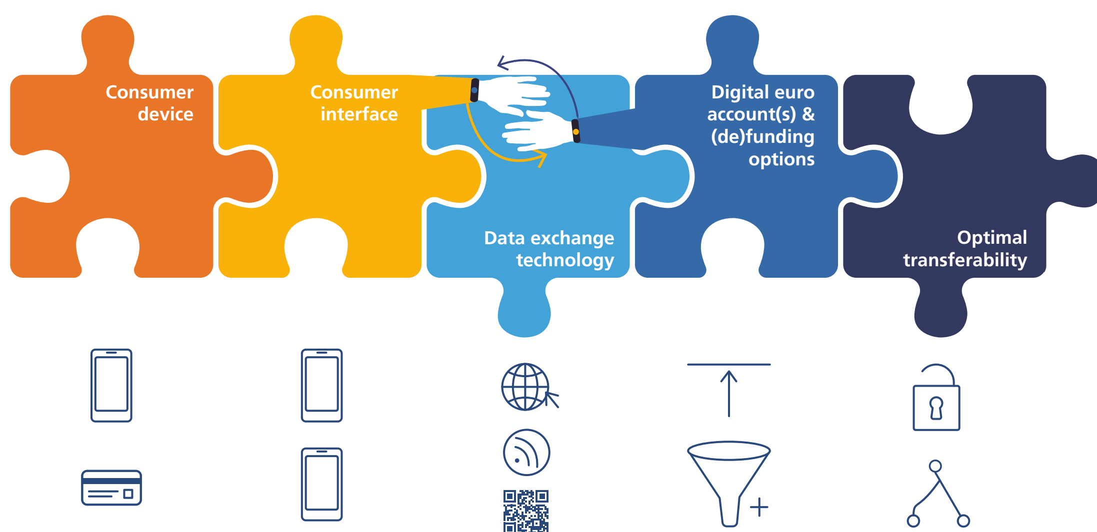
The Governing Council launched the preparatory phase following an investigative phase which ended in October 2023. This initial phase examined the feasibility of creating a digital euro that meets both user needs and Eurosystem requirements by developing a high-level product concept, supported by prototyping activities to approve the proposed concept and focus group research to determine user preferences and expectations. This in-depth work is described in more detail below.

High-level design

Throughout the investigative phase, the Eurosystem's objective was to ensure that the digital euro would be a versatile currency,

Figure B.2

Characteristics of the digital euro



Sources: ECB, NBB.

accessible both online and offline and covering all retail payment use cases throughout the euro area, instantly and free of charge (for basic use). Its main applications should include person-to-person transactions as well as e-commerce and point-of-sale purchases, both in shops and online. The digital euro should also enable government-to-individual or business-to-business use, facilitating interactions between these parties, including the payment of benefits and allowances, subsidies and taxes.

In addition, the digital euro could enable small-value payments to be made offline, thereby protecting the user's privacy in the same way as the anonymity associated with cash. Technically, the user's bank (or any other payment service provider) would have no way of knowing to whom a transfer is made, or the amount involved, when the digital euro is used offline. The only information the bank would have would be the amount available in the user's virtual wallet when entering offline mode and the balance when returning online. Everything that happens in between would be strictly confidential. At the same time, transactions carried out online would enjoy the same level of confidentiality as traditional electronic payments.

The process to initiate and complete a digital euro transaction should be specifically designed to be user-friendly and streamlined. Users should be able to make payments using a smartphone or payment card. Ordinary banking applications and a specific application provided by the Eurosystem would be used to initiate online and offline payments and to access a digital euro wallet on a mobile device. Payments could be validated in two different ways (distinct from online validation in the context of e-commerce), with the use of near field communication (NFC) or quick response (QR) codes being envisaged for this purpose.

Once these steps in the consumer-facing process have been completed, the information would be transmitted to payment service providers and the Eurosystem. At this stage, it will be important to distinguish between online and offline payments.

In the case of offline payments, there would be no anti-money laundering controls, as only small amounts could be transferred in this mode. Funds pre-loaded and securely stored on the device (in the universal integrated circuit card, SIM card or secure element embedded (eSE) card, microSD card, etc.) would be verified and validated on a peer-to-peer basis, without the intervention of a payment service provider or the Eurosystem. The final result of the transaction (debit or credit) would then appear in the digital euro tokens stored on the device.

For online payments, the user's payment service provider (usually a bank) would carry out checks to identify fraudulent use of the digital euro, as is currently done for electronic payments. Subsequently, the credit and debit instructions would be sent to the Eurosystem for verification and recording (third-party validation) and, finally, reflected in the user's balance with the Eurosystem. It should be noted that in the context of online payments, there would also be a means of executing transactions for an amount excess of the maximum individual digital balance (a limit of € 3,000 is currently under consideration). In this case, any surplus or deficit would be automatically credited or debited to the user's (regular) bank account. These features, combined with automatic and manual (de)funding between the associated commercial bank account and the online digital euro account, would allow effective use of the digital euro as a medium of exchange (ensuring that the holding limit does not become a transaction limit) while preventing it from being used as a store of value.

Finally, it should be noted that the digital euro infrastructure should allow users to change their digital euro payment service provider in the same way as they change their telecommunications service provider. This would avoid "lock-ins", whereby users are tied to a payment service provider, and would facilitate the transition, particularly in emergency situations where the payment service provider is no longer able to provide services in relation to the digital euro account. This would also contribute to the resilience of the European payments landscape.

Evolving with the times

Parallels can be drawn between the move towards a digital euro and the changes taking place in society today. The digital euro initiative is a strategic step towards increasing Europe's autonomy and resilience in the digital financial landscape. By reducing dependence on external (private) service providers, particularly in times of potential crisis or geopolitical tensions, the digital euro would guarantee

a public means of payment developed under pan-European governance and standards.

In addition, developments such as crypto assets, the metaverse and artificial intelligence are undoubtedly heralding a major shift towards the digital realm. Europe's currency must be ready to meet these changes and continue to evolve in lockstep with the society it serves. This includes enabling machine-to-machine transactions as part of the fourth industrial revolution and facilitating conditional payments in the evolving Web 3.0 landscape.

At the same time, it is important to note that the European Commission launched the legislative process for the digital euro by publishing its Single Currency Package in June 2023.[1] This proposal is currently being examined by the European Parliament and the Council. It effectively recognises that in a digitalising society it is important to adapt the key features of physical cash – such as confidentiality, offline usability, resilience, mandatory acceptance and a distinctive European brand – to the digital domain. It should be noted that the European Commission, like the ECB, has a clearly defined objective: the digital euro is not intended to replace physical cash but rather to serve as an additional option for consumers and merchants, regardless of when and where the payment occurs. The European Commission has therefore included in its legislative proposal a provision on the legal tender nature of cash, in order to preserve and protect the role of cash in our society.

Although significant progress has been made, it is worth noting that there is as yet no final decision on the introduction of a digital euro. This decision is a matter for the Governing Council of the ECB and will form the object of a proportionality assessment at the end of the legislative process.

7.2 Payment services and "open finance"

The second Payment Services Directive (PSD2) governs the status of payment institutions and codifies consumer protection rules in the area of payments. The directive also provides for two important new features. Firstly, it introduces the concept of strong customer authentication (SCA), thereby considerably strengthening the security procedures to authorise an online payment. Secondly, PSD2 introduces "open banking", providing a statutory framework for access by fintech companies to payment accounts held with credit institutions.

1 Single Currency Package (europa.eu).

Last June, the European Commission presented a proposal for a revision of PSD2, which will lead to a third Payment Services Directive (PSD3) and includes a proposal for a Payment Services Regulation. The main idea of the proposal is to group together the prudential rules on the status, rights and obligations of payment institutions in the new directive and to incorporate the remaining rules granting rights to consumers and merchants in a directly applicable regulation. The regulation will govern liability in the event of problems or fraud in the execution of a payment. It will also include rules on SCA and open banking. The proposal is currently the subject of negotiations between the European Parliament and the Council.

One of the main areas of supervisory activity in recent years has been the examination of compliance by the fintech community with the rules on access to payment accounts. The European Commission's aforementioned proposal for a regulation does not derogate significantly from the open banking principles set out in PSD2. For example, open banking has not been made payable for fintech companies and there is no detailed scheme defining how such access should be implemented in practice. Nevertheless, the regulation does contain a number of useful clarifications to the regulatory framework.

Last year, the European Commission also submitted a proposal for a regulation on a Financial Data Access Framework. The scope of this proposal, which is also currently being negotiated by the European co-legislators, is much broader than that of the PS Regulation. It covers customer data in areas such as investments, pensions, the extension of credit, savings, etc. Payment accounts are not covered, however. One difference with PSD2 is that the European Commission provides for financial compensation for the supply of these data to third parties and stipulates that access must be through systems to be set up by the parties concerned.

7.3 Artificial intelligence

Given the growing use of artificial intelligence, the need for regulation and sound governance

principles to ensure reliable and ethical artificial intelligence has become crucial.

The use of artificial intelligence (AI) is increasing worldwide, and the emergence of generative AI models[1] will only amplify this trend. The financial sector is also making increasing use of AI. Several areas appear promising in this regard, such as fraud detection and risk selection. For example, banks can use AI to assess a borrower's credit risk, in order to decide whether and how much to lend.

These developments are being closely monitored by international, European and national regulators, notably through meetings with banks and questionnaires.

Like any technology, AI can offer opportunities, but it also poses new risks, such as a lack of transparency or reliability and discrimination. Financial institutions need to manage these risks in line with their general prudential obligations.

Since 2021, EIOPA has defined governance principles for reliable and ethical artificial intelligence in the insurance sector. These principles include fairness and non-discrimination, transparency and explainability, human oversight, data governance, and robustness and performance.

The EBA is also pushing banks to comply with more precise expectations when granting and monitoring loans. In particular, it requires that models be interpretable, that any bias[2] in the decision-making process be detected and form the object of preventive measures, and that models be well documented.

Work is currently underway at international and European level (BCBS, EBA and ECB) to establish more precise supervisory expectations for banks using AI. This will reduce the current uncertainty among financial institutions as to how these tools will be assessed by the supervisory authorities.

The implementation of techniques to ensure a good understanding of AI models and their results is one of the main points of attention for international and European supervisors. Particular attention will be paid to potential bias and ethical considerations in view of the often less transparent nature of certain models and the greater quantity of data – particularly unstructured data – used by AI.

Supervisors are also developing new internal tools based on AI to optimise their work.

Finally, the first legislation in the world regulating AI in all sectors of the economy, particularly the riskiest uses, is expected to see the light of day in Europe in the course of 2024 (see also section E.2.2 of the 2022 annual report).

7.4 Fintech

Mapping

Fintechs[3] are likely to bring about potentially disruptive structural changes in the financial sector. The financial innovations in question relate to a vast field of applications in different financial segments and can be provided by companies with heterogeneous profiles, originating in different (financial or non-financial) sectors, of different sizes and operating with or without supervisory approval.

If fintech can prove to be a strategic sector for the Belgian economy, the companies active in this field will warrant the attention of the authorities. In order to establish an initial objective basis and following a request by the government, the Bank carried out a study of the sector in 2023. Its aim was to map the various segments underpinning the sector, assess their economic importance, and identify the main financial markers of fintech companies. The study also identified the various cross-cutting axes around which fintechs gravitate in the Belgian ecosystem, as well as their possible levers and facilitators.

1 Generative AI refers to algorithms (such as ChatGPT) that can be used to create new content such as text, images, or audio, coding or video files. It involves the use of an algorithm to identify patterns and relationships in data or human-created content, which it then applies to create new content.

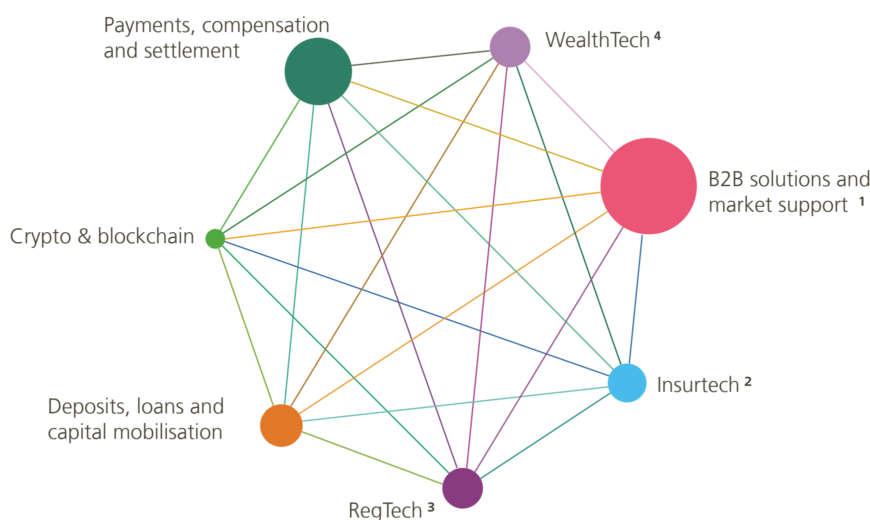
2 Bias means the results of a model (whether or not based on artificial intelligence) are not neutral or fair. It can lead to a systematic disadvantage in access to certain fundamental rights such as the right to employment, education, justice or essential financial services. Bias can arise in particular when the data used to train a learning algorithm reflect the implicit values of the individuals who collect or select them. A typical example is the refusal of credit based on a postal code that implicitly refers to the ethnic origin of those living in the municipality concerned.

3 As defined by the Financial Stability Board, fintech means digital technological innovations in financial services that can lead to new business models, applications, processes or products, with a significant effect on financial markets, financial institutions and the provision of financial services. Financial Stability Board (2017), Financial Stability Implications from FinTech, Supervisory and Regulatory Issues that Merit Authorities' Attention, 27 June 2017, www.fsb.org/wp-content/uploads/R270617.pdf.

Figure B.3

Mapping of the Belgian fintech ecosystem

(the size of the circles is proportionate to the number of companies per segment)



Source: NBB.

1 B2B (business-to-business): digital solutions designed for business-to-business financial relations.

2 Insurtech: digital solutions and innovative business models for the distribution (comparison portals, digital brokers) and/or underwriting of insurance products and services (mobile insurance applications, integrated online insurance, on-demand cover, peer-to-peer insurance).

3 RegTech: digital applications to facilitate regulatory compliance and reporting by financial and non-financial institutions.

4 WealthTech: digital investment portfolio management platforms, including the automation of financial advice on investment products and the customer interface using algorithms (robo-advice and robo-management).

The mapping of the ecosystem identified two main business segments. The first is the provision of business-to-business (B2B) digital financial solutions, particularly to the financial sector ("Tech4fin"). Belgium is naturally less oriented towards fintech products and services aimed at consumers (B2C), as Belgian banks are already largely covered by their own products and services in this area. The second segment relates to payments, reflecting in part the presence of leading international players in Belgium.

The economic importance of fintechs remains limited to date. The sector represents only a fraction of the total value added of non-financial corporations (0.3 % in 2021). The number of jobs in the sector has been growing (there were fewer than 6 000 full-time equivalents in 2021) but remains concentrated in large groups offering payment and market infrastructure solutions. The fabric of the sector is made up of a large number of SMEs and start-ups whose increasing entry in recent years has been partly stimulated by legislative changes, such as the second European directive on payment services in January 2018 ("PSD2"), and by the emergence of opportunities and innovations in certain segments (RegTech, blockchain). The balance sheets of these companies show that they are innovative and have knowledge-intensive assets. They also have recourse to financing through fundraising, notably from Belgian and foreign funds. In contrast, their profitability is relatively lower than the average for the reference group in the IT sector; this remains an intrinsic characteristic of innovative companies in the start-up phase.

Several factors act as facilitators in the ecosystem. Admittedly, the Belgian market remains limited compared with other European markets, particularly in the tech4fin segment, owing to the concentration of the Belgian financial sector. That being said, the size of the market is not necessarily perceived as an obstacle, provided companies are able to develop innovations that evidence a robust business model and a mastery of risk, as well as a strong ambition to expand internationally. The attraction of European and international companies in business segments that satisfy unmet needs is also seen as a positive factor for the development of the ecosystem. The Belgian ecosystem benefits from a good pool of talent and

cutting-edge technological skills, linked to the quality of Belgian scientific research and its specialisation in areas that will prove promising for the future development of digital financial services (cybersecurity, artificial intelligence, quantum computing, etc.).

Nevertheless, the transition from the start-up phase to the growth and acceleration phase ("scale-up") remains more complicated. Among other things, the potential for partnerships with financial institutions, as well as access to medium-ticket fund-raising, can be a constraint. Matching and connecting start-ups with private and public funds, in line with the profiles of these companies, could be strengthened. The availability of human capital in a sector with cutting-edge technological capabilities is a challenge for the future, particularly in areas where industrial demand is strong, such as artificial intelligence. Finally, the various players with a significant impact on the sector's value-added creation (financial institutions and start-ups, academia, incubators, venture capitalists and public investors, structures promoting cooperation and matching between companies and investors) could be better interconnected in order to capitalise on network effects and initiate self-sustained growth to make the ecosystem more attractive.

Fintech survey of credit institutions

In 2017, the Bank conducted a survey on fintech and digitalisation among selected banks and financial institutions. This survey provided an overview of the impact of fintech on the Belgian financial sector and initiated a dialogue with market participants on various topics related to digitalisation. In the light of technological and market developments, a new survey was conducted by the Bank in 2020, the results of which were provided to banks in 2021 and formed the subject of a public report in 2022.

This Belgian survey was followed by initiatives by the ECB concerning digitalisation and fintech within the SSM in view of the strategic importance of the digital transformation of banks. The ECB carried out a survey on digital transformation and the use of fintech by credit institutions of significant importance in 2022. The results were published in February 2023. In the summer of 2023, the ECB supplemented this survey with a first targeted review of the digital transformation of a selection of significant credit institutions, including a few Belgian banks. The publication of the high-level results of this review is scheduled for 2024.

In view of major developments in financial technologies and the fact that the ECB's survey and targeted reviews cover only large banking groups, the Bank decided to launch a new survey focusing on local or specialised credit institutions in the summer of 2023. The first responses were received at the end of 2023 and are currently being analysed. The purpose of this survey is to enable the Bank to update its knowledge of the digital transformation underway at these banks and to follow up on recommendations made in the framework of previous surveys.

Insurtech

Technological innovation is also increasingly impacting the business model of insurance companies. These rapid changes are not only creating opportunities for start-ups and established technology companies to provide financial services, but are also enabling traditional insurers to adapt and improve their business model, services and products. However, these new trends may also give rise to new risks or amplify existing risks.

In this context, the Bank contributed, within EIOPA, to the drafting of new guidelines for supervisory authorities to help them analyse the business model of insurance companies with highly developed digital activities. For technologies such as artificial intelligence, big data, crypto assets, the Internet of Things, etc., the opportunities and risks for the insurance sector were analysed and the impact on the activities (e.g. on pricing, claims management, etc.) of insurance companies mapped. In addition, tools were developed to estimate the degree of digitalisation of a company's operations and the long-term viability of its business model. This work should make it possible to determine which European companies could see their financial viability compromised by the use of new technologies and which could successfully develop their digital activities.

Finally, specific cases were compared between different digital players active in the financial sector. The results revealed that digital activities have been implemented with varying degrees of success in the insurance sector. In addition, this comparison made it possible to formulate points for attention by supervisors. For some technology companies, it was noted that they need a certain amount of time to achieve sustainable profitability and that they must therefore have solid financial reserves.

7.5 Digital operational resilience

Digital Operational Resilience Act

The European Digital Operational Resilience Act (DORA) entered into force on 16 January 2023.[1] Its provisions apply as from 17 January 2025.

The impetus for this regulation was the sector's ever-increasing reliance on digital assets and processes. As a result, information and communication technology (ICT) risks represent a growing challenge to the operational resilience, performance and stability of the European financial system. Furthermore, the European Commission considered that previous legislation had not addressed this issue in a sufficiently detailed and comprehensive manner, had not provided financial supervisors with the most appropriate tools to carry out their tasks, and had left too much room for divergent approaches within the single market. In a joint technical advice, the European Supervisory Authorities (ESAs) had also called for a more coherent approach to ICT risk management in the financial sector.

DORA is based on five pillars:

- The first pillar consists of key principles and requirements for ICT risk governance and management, inspired by relevant international and sectoral standards, guidelines and recommendations. These requirements cover specific aspects of ICT risk management (identification, protection and prevention, detection, response and recovery, learning and development, and communication) and underline the importance of an appropriate policy and organisational framework. The crucial and active role to be played by the management body in setting up an ICT risk management framework and in assigning clear roles and responsibilities for ICT functions falls, among other things, under the first pillar.

- The second pillar contains requirements for the management and classification of ICT-related incidents, as well as provisions to harmonise and streamline the reporting of significant incidents to the competent regulatory authorities. In addition, this pillar addresses the responsibility of

1 Regulation (EU) 2022/2554 of the European Parliament and of the Council of 14 December 2022 on the digital operational resilience of the financial sector and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014, (EU) No 909/2014 and (EU) 2016/1011.

the regulatory authorities to provide feedback and support to financial entities and to transmit relevant data to other authorities with a legitimate interest. The aim is for financial entities to have to report significant incidents to a single competent authority. In this respect, the ESAs, the ECB and the European Union Agency for Cybersecurity (ENISA) will study the feasibility of a European platform. The incident reporting obligations of PSD2 will be fully integrated into this pillar.

- The third pillar concerns digital operational resilience testing requirements, i.e. the periodic assessment of resilience to cyber-attacks and the identification of weaknesses, failures or gaps, as well as the prompt implementation of corrective measures. While all financial entities are required to test their ICT systems, which can range from vulnerability scans to software code analysis, only those entities identified as significant by the competent authorities will be required to conduct threat-led penetration testing.

- Fourthly, DORA contains provisions designed to ensure proper management of the ICT-related risks associated with ICT third-party service providers. On the one hand, this objective will be achieved through the imposition of basic rules on the monitoring of such risks by financial entities and the introduction of regulations harmonising key aspects of the provision of services and the relationship with ICT third-party service providers. On the other hand, DORA aims to promote the convergence of approaches to the monitoring of risks related to ICT third-party service providers in the financial sector by establishing an oversight framework for critical ICT third-party service providers.

- The fifth and final pillar is intended to raise awareness of ICT-related risks and associated issues. This pillar focuses on limiting the spread of these risks and supporting defensive capabilities and threat detection techniques, in particular by explicitly allowing financial entities to conclude information sharing agreements on cyber threats.

In order to maximise harmonisation within the financial sector, DORA is aimed at a wide range of financial entities, including central securities depositories, credit institutions, insurance and reinsurance companies, stockbroking firms, payment institutions and electronic money institutions.

DORA should be seen as a *lex specialis* in relation to the EU directive on measures to ensure a high common level of cybersecurity across the Union (also known as the “NIS 2 Directive”).[1] This means that the requirements of DORA, for example with regard to ICT security or incident reporting, go beyond those of the NIS 2 Directive, and that institutions subject to DORA need only comply with the provisions of DORA, unless – which is not expected – the national legislation transposing NIS 2 Directive explicitly extends its scope or provisions.

Given the strong interconnection between the digital and physical resilience of financial entities, the obligations of Chapters III and IV of the Critical Entity Resilience Directive (CER Directive)[2] do not apply to financial institutions covered by DORA. Again, the national legislation transposing the CER Directive could extend its scope or provisions.

The Bank is committed to ensuring the successful implementation of DORA in a number of ways:

- On the one hand, it is actively contributing to the creation of level 2 texts to clarify DORA in many areas. This work resulted in a first set of standards on the ICT-related risk management framework, criteria on the classification of ICT-related incidents, policies relating to ICT third-party service providers that support critical or important business functions and, finally, templates to be used for the reporting of ICT dependencies to the competent authorities.[3] A second set of documents is due to be finalised by 17 July 2024 and will include provisions on the reporting of significant ICT-related incidents, as well as advanced threat-led penetration testing, the subcontracting of ICT-related services that support critical or important functions, and standards for effective oversight of critical ICT third-party service providers. This second set of documents is currently the subject of a public consultation.[1]

1 Directive (EU) 2022/2555 of the European Parliament and of the Council of 14 December 2022 on measures to ensure a high common level of cybersecurity across the Union, amending Regulation (EU) No 910/2014 and Directive (EU) 2018/1972, and repealing Directive (EU) 2016/1148.

2 Directive (EU) 2022/2557 of the European Parliament and of the Council of 14 December 2022 on the resilience of critical entities and repealing Council Directive 2008/114/EC.

3 ESAs publish first set of rules under DORA for ICT and third-party risk management and incident classification | European Banking Authority (europa.eu).

- On the other hand, it is very actively involved in the successful implementation of DORA through raising awareness in the sector by means of various seminars and communications, facilitating the integration of DORA into Belgian law, developing the necessary IT tools and processes, adapting existing supervisory methodologies, and anticipating insofar as possible the impact that the oversight of critical ICT third-party service providers will have on its work.

8. Resolution

Insofar as resolution is concerned, 2023 marked the end of an important cycle, bringing to a close the transition period for the first phase of development of the Single Resolution Mechanism (SRM). This resulted in three major achievements. First, the transition period for banks to meet the expectations of the Single Resolution Board (SRB) was completed at the end of 2023. Secondly, the transition period defined in 2019 in BRRD2 [2] to meet the minimum requirement for own funds and eligible liabilities (MREL) ended on 1 January 2024. Thirdly, 2023 was also the last year of the initial period for constitution of the Single Resolution Fund, during which resources corresponding to 1 % of covered deposits held by credit institutions established within the banking union were collected from the banking sector. This means that credit institutions have now developed the operational capabilities needed for resolution and have built up the financial buffers required to absorb losses and subsequently contribute to recapitalisation. In addition, substantial financial resources have been made available to the SRB to facilitate the implementation of resolution proceedings.

As one period draws to a close, another begins, with new projects in the pipeline, one of the main objectives of which will be to test the capabilities developed by banks to operationalise their resolution strategy. In order to determine the best approach to organise this work, the Single Resolution Mechanism launched a strategic review in 2023, one of the aims of which was to define the objectives to be achieved over the next five years. 2024 will also be marked by the negotiation of a series of improvements to the European legislative framework governing resolution (a project known by the acronym CMDI, which stands for Crisis Management and Deposit Insurance). These negotiations will be led by the Belgian presidency of the Council of the European Union in the first half of 2024.

8.1 Resolvability - 2023: the end of a cycle

Operationalisation of resolution strategies

In 2020, the SRB published its “Expectations for Banks”, setting out principles and expectations for the resolution strategies of credit institutions. Credit institutions in the banking union were expected to build up specific capabilities by the end of 2023 to enable them to implement their resolution strategy in the event of a crisis. As the SRB adopted a phased approach, priorities to be addressed by banks were determined for each yearly resolution planning cycle between 2020 and 2023. For 2023, these consisted of the continued development of bail-in playbooks, with particular attention to the mechanisms for upstreaming losses from subsidiaries to the resolution entity and downstreaming capital from the resolution entity to its subsidiaries subject to a single point of entry (SPE) strategy. [3] The development of capabilities to establish a business reorganisation plan after a bail-in and separability were complementary priorities.

The SRB’s resolvability assessment [4] confirmed that banks have made steady progress on all aspects addressed by the Expectations for Banks. The Belgian banks under the SRB’s remit also built up their resolvability capabilities by the end of 2023. However, resolution planning is an iterative process. Not only should banks remain constantly attentive to compliance with the principles set out in the Expectations for Banks, but they will also have to test and, if necessary, adjust their resolvability capabilities. Now that these capabilities have been built

1 ESAs launch joint consultation on second batch of policy mandates under the Digital Operational Resilience Act | European Banking Authority (europa.eu).

2 Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorption capacity and recapitalisation of credit institutions and investment firms and Directive 98/26/EC.

3 This strategy – provided for in the resolution plan – consists of designating a single group entity as the “resolution entity” and applying to this entity alone the resolution tools in the event of a crisis. For more information on the SPE strategy, see the Bank’s 2022 annual report.

4 SRB, *Resolvability of Banking Union Banks*: 2022, September 2023.

up, including through the development of playbooks – which are important for the operationalisation of resolution strategies – attention should turn to testing.

The SRB's Expectations for Banks are also applied by the Bank to less significant institutions (LSIs) under its remit, when the resolution plan provides for their resolution. However, when determining the timeframe applicable to these LSIs, the Bank also takes into account the characteristics of the institutions concerned and grants them an additional year to meet the Expectations for Banks. As a result, the resolvability capabilities of LSIs will be tested for the first time in 2024.

Minimum requirement for own funds and eligible liabilities

In addition to the qualitative requirements that credit institutions must meet in order to be resolvable, there is also a quantitative requirement: the MREL. The MREL must ensure that a credit institution's shareholders and creditors/investors absorb losses and are responsible for recapitalising the bank. The aim is to avoid taxpayers having to bear the cost of a credit institution's failure, as was the case during the previous financial crisis.

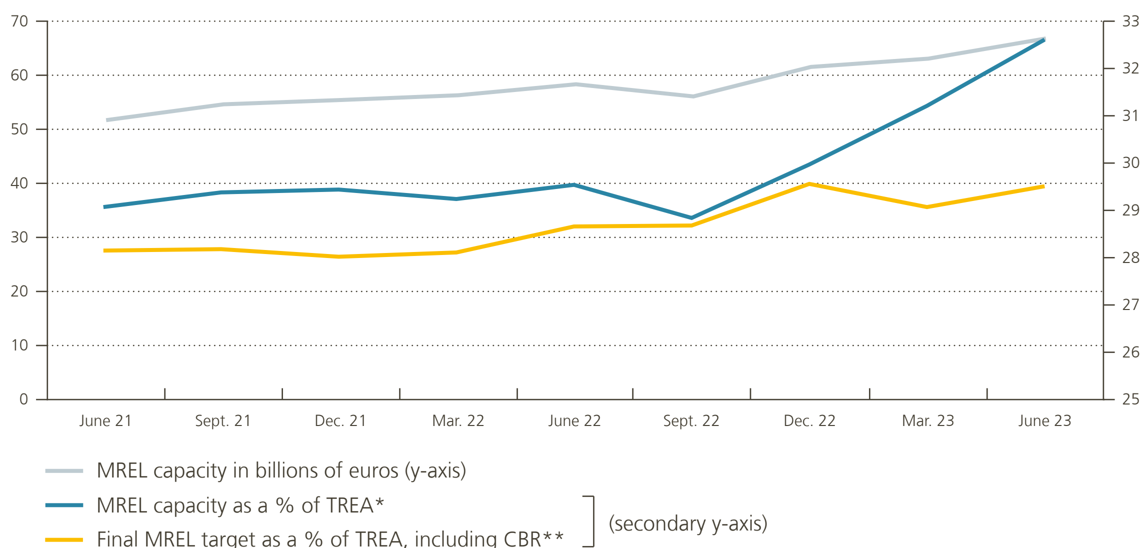
The 2023 resolution planning cycle was a pivotal one, as it was the last opportunity for banks to build up sufficient capacity to meet their final MREL targets. Despite the turbulence faced by the banking sector globally in the first half of 2023 (see section B.1), a significant volume of MREL instruments was issued. In the first half of the year, eligible liabilities amounting to € 4 976.61 million were issued by Belgian credit institutions, compared with € 3 878.85 million in the first half of 2022. In the third quarter of 2023 as well, Belgian credit institutions remained active on the MREL market.[1]

Figure 4 shows how the external MREL capacity of Belgian credit institutions with a resolution strategy has evolved since June 2021.

1 These figures are based on the SRB's MREL quarterly data collection. This report is also submitted by smaller institutions under Belgian law that have a resolution strategy.

Figure B.4

Composition of the external MREL capacity of Belgian credit institutions with a resolution strategy



Source: MREL-TLAC quarterly reporting. This reporting is required in accordance with Commission Implementing Regulation (EU) 2021/763 of 23 April 2021 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council and Directive 2014/59/EU of the European Parliament and of the Council with regard to the supervisory reporting and public disclosure of the minimum requirement for own funds and eligible liabilities. It should be noted that this reporting only applies to banks subject to a BRRD2-based MREL and a resolution strategy that is not based on liquidation through regular insolvency procedures.

* Total risk exposure amount (TREA)

** Combined buffer requirement (CBR).

The MREL is expressed in relation to the total risk exposure amount and the total exposure measure, meaning the absolute amount varies over time. In addition, Tier 2 instruments and eligible liabilities are limited in time, obliging the credit institution concerned to renew them regularly in order to maintain sufficient MREL capacity. Moreover, credit institutions continue to trade in MREL instruments to meet their own internal management buffers.

Single Resolution Fund

In 2023, the last year of the transition period for establishment of the Single Resolution Fund (SRF), the institutions concerned contributed a total of € 11.7 billion (€ 13.7 billion in 2022). Of these contributions, € 330.1 million came from institutions governed by Belgian law, compared with € 447.6 million in 2022. This drop can be explained, among other factors, by the reduction in the expected target level for the banking union.[1] In 2023, the SRB forecast that the amount to be reached by the SRF should be € 77.6 billion and not € 80.0 billion as estimated in 2022.[2] At the end of the eight-year build-up period, Belgian credit institutions will have contributed € 2.7 billion or more than 3.5 % of the SRF's reserves.

It will be necessary to wait until the first quarter of 2024 to determine whether the amount reached in 2023 is sufficient to avoid having to collect contributions in 2024. The target amount is dynamic and evolves depending on changes in the level of covered deposits in the banking union. The amount to be collected in the future will depend on this evolution and on possible recourse to the SRF in the context of resolution. Each year, the SRB will check whether the financial resources available to the SRF exceed the target level. If they fall below this level, the SRB may collect new contributions.

8.2 2024: the start of a new resolution cycle

While 2023 marked the end of a cycle, 2024 will be characterised by the need to define new horizons, so as to consolidate and test the resolvability of credit institutions and strengthen the legislative framework for resolution, for both banks and insurance companies. This work, with which the authorities are currently busy, should be completed in the coming months.

Bank resolvability: a new approach to testing the operationalisation of resolution strategies

Now that credit institutions within the banking union have developed their resolvability capabilities pursuant to the Expectations for Banks, it is important to ensure that these capabilities are maintained and updated and to test their effectiveness. Such tests can be carried out in a variety of ways, for example stress tests, on-site inspections or dry runs. Dry runs enable banks to ensure that their resolution plans can actually be put into practice. They also enable them to identify any areas where further work may be warranted so as to be able to act swiftly in a crisis. Most Belgian credit institutions have already carried out such tests, mainly with regard to the bail-in tool and the provision of information by their management information systems. However, they will also need to test their resolvability capabilities in a more structured way, using common criteria defined in the SRB multiannual work programme. This will be a recurring exercise, designed to improve the quality and applicability of the developed resolvability capabilities and to identify any shortcomings, which will then be rectified. Implementing these tests, which will form the core of the Single Resolution Mechanism's work programme over the next few years, will require the use of new methodologies and practices.

In order to establish its new work programme, the SRB has launched a review, known as "Vision 2028", aimed at redefining its strategy for the next five years. The main aim of this review, which began with a wide-ranging consultation of both internal and external stakeholders, is to define the priorities for resolution planning, with a particular focus on a programme to test resolvability capabilities. It also aims to adapt the SRB's organisation to enhance its effectiveness, taking into account changes in its activities, and to equip it as adequately as possible for the challenges that lie ahead. This new strategy should be finalised and made public by the SRB in the early months of 2024.

1 Equal to at least 1 % of the total amount of covered deposits held by banks and investment firms established in the banking union.

2 This decrease was mainly due to a deceleration in the growth of covered deposits at the level of the banking union.

Extending the banking resolution framework: CMDI

On 18 April 2023, the European Commission published a package of legislative proposals to reform and strengthen the common framework for bank crisis management and national deposit insurance schemes. The package, known as the bank crisis management and deposit insurance framework (abbreviated CMDI), aims to amend the Bank Recovery and Resolution Directive (BRRD),[1] the Single Resolution Mechanism Regulation (SRMR),[2] and the Deposit Guarantee Schemes Directive (DGSD)[3] in order to comply with the Eurogroup statement of 16 June 2022 on the future of the banking union and, in particular, to expand access to the resolution framework to small and medium-sized institutions. In essence, the Commission's proposal aims to broaden the scope of the resolution framework by revising the third condition for resolution, namely assessment of the public interest. It also proposes facilitating the use of funds from deposit guarantee schemes to finance the resolution of such banks under certain conditions, it being understood that the MREL remains the first line of defence for them as well.

The public interest assessment

The public interest assessment determines whether the normal insolvency rules can be derogated from by applying resolution tools when an institution is failing or likely to fail. Since the introduction of the resolution framework, however, the European Commission has noted that various resolution authorities interpret the public interest assessment narrowly and that this concept should therefore be harmonised and broadened. Under the current framework, resolution can only be opted for when this is necessary to achieve the resolution objectives and provided these objectives cannot be achieved to the same extent through normal insolvency proceedings. The CMDI proposal modifies the wording of the assessment to provide that insolvency proceedings can only be opted for if these proceedings allow the resolution objectives to be achieved more effectively – thus not simply to the same extent – than would be the case in resolution. This amendment should make it easier to determine, in the case of small and medium-sized credit institutions, that resolution is in the public interest.[4]

Financing resolution

Ensuring easier access to the resolution framework necessitates raising the issue of how to finance resolution. The MREL remains the first line of defence for an institution facing financial difficulties. This first line of funding can, under certain conditions, be supplemented by financing sources set up by the industry, in particular resolution funds and deposit guarantee schemes.[5] However, the restrictive rules on access to funds in the context of resolution can hamper their use in practice. The Commission, with the objective of protecting taxpayer money, proposes the introduction of a general depositor preference (in other words, deposits protected by a deposit guarantee scheme would benefit from the same preference as all other deposits in the hierarchy of creditors, whereas they currently have preferred status) and to allow deposit guarantee schemes to intervene under certain conditions in order to unlock access to resolution funds for entities under resolution. Greater recourse to safety nets financed by the private sector, combined with robust internal loss absorbing capacity, should make it possible to better protect taxpayers and depositors in times of crisis.

Modified resolution objectives

In addition to revising the public interest assessment and the financing options, the European Commission is also proposing some changes to

1 Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and financing of resolution action, 18 April 2023, COM(2023) 227 final - 2023/0112 (COD).

2 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards early intervention measures, conditions for resolution and funding of resolution action, 18 April 2023 COM(2023) 226 final - 2023/0111 (COD).

3 Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/49/EU as regards the scope of deposit protection, use of deposit guarantee scheme funds, cross-border cooperation, and transparency 18 April 2023, COM(2023) 228 final - 2023/0115 (COD).

4 Based on an analysis of the impact of the proposed new framework, the SRB estimates that it could affect 26 banks. These institutions, currently identified as banks eligible for liquidation under the normal insolvency procedure, could, in the SRB's view, be subject to resolution. This analysis was presented by the SRB at a joint seminar with the SSM on 16 October 2023 (https://www.srb.europa.eu/system/files/media/document/2023-10-19_SRB-SSM-Seminar-Impact-of-CMDI-changes-on-funding-SL.pdf).

5 A deposit guarantee scheme is a fund set up at national level to provide compensation of up to € 100 000 to eligible depositors in the event of the failure of their bank. The Single Resolution Fund is the resolution fund set up at the level of the banking union to facilitate the implementation of resolution action, under certain conditions, when this proves necessary.

the resolution objectives. For example, the CMDI package modifies the resolution objective requiring that reliance on public financial support be minimised. Conversely, it stipulates that when a credit institution under resolution requires public financial support, financing from industry-funded safety nets should be preferred to public funding. In addition, the CMDI package provides that resolution should aim to protect all depositors, while minimising losses for deposit guarantee schemes. In this way, the Commission modifies the current resolution objective of protecting only covered depositors. It also introduces an assessment of critical functions at regional level. Under the CMDI package, when a resolution authority is considering placing a credit institution under resolution, it will have to take into account the consequences resulting from the interruption of these functions for the real economy and financial stability, at both national and regional level. This will make it possible to place under resolution not only banks of national importance but also those whose failure would have a significant impact at regional level only.

Selected topics

Finally, the CMDI package includes a large number of technical amendments. The main example is the introduction of an early warning that the supervisory authority must send to the resolution authority when it is of the opinion that there is a significant risk of (imminent) failure of an entity, to be accompanied by a statement of possible solutions to avoid failure.

Negotiations on the European Commission's proposal for the CMDI framework began during the year under review and are important for progress on the banking union. Over the coming year, the Bank will play a key role in this matter under the Belgian presidency of the Council of the European Union.

Resolution for insurance companies: a framework for the future

The European Parliament and the Council reached (provisional) agreement on a directive establishing a framework for the recovery and resolution of insurance and reinsurance companies (Insurance Recovery and Resolution Directive or IRRD). Following publication of the text by the European Commission in September 2021, an agreement was also reached within the Council in December 2022. During the year under review, trilogues between the European Commission, the Council and the European Parliament took place, and in mid-December the Council and the Parliament reached a (provisional) political agreement. In January 2024, work continued under the Belgian presidency and negotiations on the technical aspects of the provisional political agreement were also finalised. The agreement will remain "provisional" until the Council and the Parliament formally confirm the text.

9. Review of Solvency II

Solvency II, the prudential supervisory framework for European insurance and reinsurance undertakings, has been in effect since 1 January 2016. It covers a wide range of quantitative and qualitative requirements relating to the taking up and pursuit of insurance and reinsurance activities. The Solvency II framework also provides for review mechanisms to enable regulatory adjustments to be made on the basis of acquired experience. EIOPA's instruction to provide technical advice to the European Commission by the end of 2020 on the review of long-term guarantee measures and measures on equity risk originated in the directive itself. Following a formal request for technical advice, this instruction was extended on 11 February 2019 to cover a range of additional aspects that make up the core of the directive.

EIOPA's advice was sent to the European Commission and published on 17 December 2020. It includes concrete proposals for changes to the regulatory framework as well as the results of a holistic impact assessment carried out at European and national levels. EIOPA's recommendations aim to improve the main quantitative, qualitative and reporting requirements of the Solvency II framework in a balanced way and to better reflect economic realities.

On 22 September 2021, following EIOPA's in-depth analyses, the European Commission put forward a package of legislative proposals to revise Solvency II. The proposed changes are based primarily, but not only, on EIOPA's advice. They are intended to support the EU's political priorities, such as financing the post-Covid-19 economic recovery, completing the capital markets union, and channelling the resources needed in the framework of the European Green Deal.

With regard to quantitative reforms, the Commission's proposal differs significantly from EIOPA's opinion. The main differences would result in an increase in own funds and a relaxation of capital requirements. In response to the package, EIOPA expressed its concerns about the relaxation of certain quantitative requirements, which could increase risks for policyholders.

The reform package proposed by the European Commission was further analysed by the Council. On 5 October 2021, the EU economy and finance ministers held an orientation debate, after which technical work got underway under the Slovenian presidency and continued under the French presidency.

On 17 June 2022, the Member States were able to agree a common position on the adjustments to be made to the European Commission's proposals. It is interesting to note that, on balance, the Council broadly shared the Commission's position on the quantitative reforms. On the other hand, there were major differences of opinion regarding the qualitative reforms, such as application of the principle of proportionality and the expectations of EIOPA for the development of instruments or guidelines, as well as its powers in the context of conflict resolution within cooperation platforms.

Discussions and debate in the European Parliament began in the summer of 2022. The positions of the various political groups were fairly divergent. After a year of negotiations, an agreement was reached on 18 July 2023 within the Committee on Economic and Monetary Affairs on adjustments to the European Commission's proposals. As far as capital requirements are concerned, the proposal goes mainly in the direction of further prudential relaxation.

The decision to start inter-institutional negotiations was confirmed at a plenary session of the European Parliament on 13 September 2023, thus kicking off the trilogue between the co-legislators. During these negotiations, the European Commission, the Parliament and the Council, represented by Spain in the second half of 2023 and by Belgium in the first half of 2024, will work together to overcome the main obstacles.

The institutions seem to agree on how to adjust capital requirements linked to interest rate risk. However, a consensus needs to be reached on calculation of the volatility adjustment, extrapolation of the risk-free rate curve and the risk margin of technical provisions.

In addition, the three institutions agree on the need to establish a proportionality framework broadly allowing companies with a low risk profile to apply

simplified measures under the three pillars of Solvency II. However, they need to reach agreement on the eligibility criteria for these simplifications, as well as on whether national supervisory authorities will have the power to refuse this option. Discussions are underway to determine whether this power should only be granted in exceptional cases or whether it should also be available in the event of serious concerns regarding solvency, management shortcomings and significant changes in the activities of a company.

Further to the principles of freedom of establishment and freedom to provide services, cross-border supervision plays an important role. The three institutions share the view that closer cooperation is needed between the supervisory authorities of the home Member State and the host Member State where cross-border activities are significant. They need to reach agreement on the criteria to be applied when qualifying cross-border activities as significant, on the arrangements for setting up collaboration platforms and on the role and powers of EIOPA in managing conflicts between supervisory authorities.

With regard to sustainability, the three institutions agree that, as part of their own risk and solvency assessment (ORSA), companies should assess any material exposure to climate-related risks and, for material exposures, the impact of at least two long-term climate change scenarios. The institutions must also agree whether to require companies to include in their public disclosures the latest results of these scenarios, as well as the relationship between their risk profile and their sustainability risks and the main negative impacts in this respect on sustainability factors.

When it comes to reporting, the three institutions agree that corporate balance sheets should be subject to audit, but need to find common ground on possible extensions and exemptions to this requirement, in particular the possibility for Member States to extend this requirement to all public reporting and to exempt companies with a low risk profile.

Institutions should decide among themselves whether users of internal models must provide the competent supervisory authorities with an annual calculation of their capital requirements according to the standard formula or whether the regulations should be adapted in this respect.

Another set of proposals concerns the adaptation of group supervision. The institutions must agree on how to identify insurance holding companies and on the powers of the supervisory authorities to eliminate obstacles to group supervision. For example, it is proposed that, in cases where the effectiveness of group supervision is compromised, the supervisory authorities be given the power to modify internal arrangements and the division of work within the group.

With regard to macroprudential supervision, the institutions must agree on whether the establishment of a liquidity risk management plan should be required. Such a plan could be made compulsory or it could be left up to the supervisory authorities to determine which undertakings are required to draw up a plan.

The non-exhaustive overview of adjustments to the Solvency II framework presented above gives an idea of the key issues on which the institutions reached a political agreement in mid-December under the Spanish presidency. In January 2024, Belgium assumed the presidency and will be responsible for finalising the technical aspects of the political agreement and subsequently implementing it.