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PRESS RELEASE

Publication of the Macroprudential Report and the Financial Stability Report

In accordance with the requirements of the law of 25 April 2014 establishing the mechanisms of a macroprudential policy, **the Bank is today publishing the second edition of the *Macroprudential Report***, which is an integral part of the *Financial Stability Report 2016*. This publication provides a comprehensive overview of financial stability conditions in Belgium and a detailed analysis of the main risk factors and vulnerabilities in the Belgian financial industry. The report also presents the main macroprudential measures adopted by the Bank during the year under review. Since the finalisation of this report and in view of persistent vulnerabilities in the residential real estate market, **the Bank has taken a decision the on implementation of an additional capital buffer targeted on the riskier segments of credit institutions' mortgage portfolios in 2017. This decision is conditional upon approval by the European Central Bank and the European Commission.**

In recent months, a number of risks originally identified by the Bank have materialised and have affected Belgian financial institutions to varying degrees. The weaker than expected economic recovery and the decline in interest rates in the various market segments, as a result of *inter alia* the very accommodative monetary policy stance, have more seriously affected the profitability of the life insurance sector. The large stock of contracts with high guaranteed rates, the existence of a duration gap and the weak level of premiums, which have fallen by 6% in 2015, have led the technical result in the life insurance business to decline by 0.5 billion euro to just 0.2 billion euro in 2015, despite significant capital gains.

In spite of the difficult economic environment, profitability in the banking sector has remained strong, with return on equity standing at 10.1% in 2015, against 7.7% in 2014. The industry has continued to benefit from a significant drop in funding costs, thus reaching a floor, and from growing revenues as a result of a certain preference for investment funds, while operational expenditure related to staff costs could be contained in the restructuring context. Temporary factors – such as early repayment charges on 2015's very large number of mortgage loan refinancing transactions and gains on financial instruments – have also supported this result. These results made it possible to further strengthen banks' solvency position beyond the minimum requirements imposed by the prudential authorities. This is important in view of the uncertainties surrounding the impact of the finalisation of the post-crisis reforms and of pressure on profitability.

The sluggish economic growth, combined with persistently low interest rates, may indeed weigh more heavily on profitability of both insurance companies and banks in the coming years, mainly due to reinvestment risk. Belgian institutions have begun to respond to this environment. Thus insurance companies have been led to offer contracts that are more in line with market conditions and have maintained their efforts in containing expenses and claims' costs. The banking sector has for its part sought to maintain margins despite increased competition, and to contain operational expenses. But **if the low interest rate environment were to persist, these measures would not be enough to ensure sustainable profitability**, particularly in a context of intense competition within the major markets and the main activities, which could be further exacerbated by an inflow of companies operating in the new financial technology (FinTech).

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In this context, **the Bank advises financial institutions to maintain their efforts by continuing to adapt their business model and cost structure to this difficult environment, which may persist. It is crucial to apply a pricing policy that is in line with the risks**, so as to ensure an adequate level of profitability. The Bank expects insurance companies and banks to continue to improve their solvency by limiting the distribution of profits to policyholders and shareholders where necessary to preserve their long-term resilience. In the light of developments in recent years, **the Bank has submitted to the Minister of Economy a proposal for a royal decree aiming to supervise the payment of profit shares to policyholders.** In particular, the Bank, in its capacity as microprudential authority, would be able to prohibit paying out profit sharing to policyholders where the financial position of a company is not sufficiently healthy. Furthermore, the Bank advises the industry to **carefully consider any realisation of capital gains, and strongly recommends not using them to distribute dividends or pay out any profit sharing to policyholders.**

In any event, in-depth reflection on organisational modes for financial intermediation activities will be required, as IT innovations continue to develop, leading to the arrival on the market of companies specialising in digital technologies. These developments also entail new operational risks, and more specifically cyber risks. The Bank therefore calls upon financial institutions to **ensure the integrity of IT systems and secure financial institutions and financial market infrastructures against cyber risks.** The Bank will ensure that systemically important institutions duly implement its circular on prudential expectations for operational business continuity and security, with particular attention to cyber-resistance.

Beyond these risks, economic and financial conditions are conducive to some search for yield. Although this has remained moderate to date, certain developments do deserve special attention. Firstly, exposures to residential and commercial real estate have continued to rise in 2015 and in the first half of 2016. The sustained growth in mortgage lending has led to a further increase in household debt (59.5% of GDP), exceeding for the first time the level recorded in the euro area (59.1%), which has been experiencing a continuous decline since 2010 in a context of deleveraging. In addition, the Bank considers that the proportion of new loans with a high risk profile remains too high, and the tightening of credit standards at originination of mortgage loans that had been observed since 2013 came to a stop in 2015. Given that vulnerabilities persist on the real estate market, **the Bank has decided, subject to approval by the ECB and the European Commission, to supplement the risk weighting add-on for banks using the internal models approach introduced in late 2013 with an additional capital buffer targeting high-risk segments.** In addition, **it urges banks to maintain prudent lending practices and ensure sufficient margins on mortgage loans in view of the various risks that may materialise in the current low interest rate environment.**

Secondly, the search for yield also **leads savings to shift towards investment funds within credit institutions and creates renewed interest for branch 23 products in the insurance business**. The shift towards alternative investment instruments is part of a trend, encouraged by concerns over performance and the various regulatory requirements, towards transferring activities from traditional financial institutions to structures operating under more relaxed regulations. **The Bank is closely monitoring the development of these new structures**, generically referred to as the shadow banking system, so as to ensure that the specific risks associated with leverage and liquidity within investment funds do not jeopardise diversification of funding sources.

Those actions which have been decided by the Bank in order to reduce systemic risks are part of a broader policy that aims to maintain confidence in the financial sector. The Bank expects financial institutions to comply with all and any legislation aiming at good governance and at limiting reputational risk.

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