3. Prudential supervision

3.1 Methods of applying prudential supervision

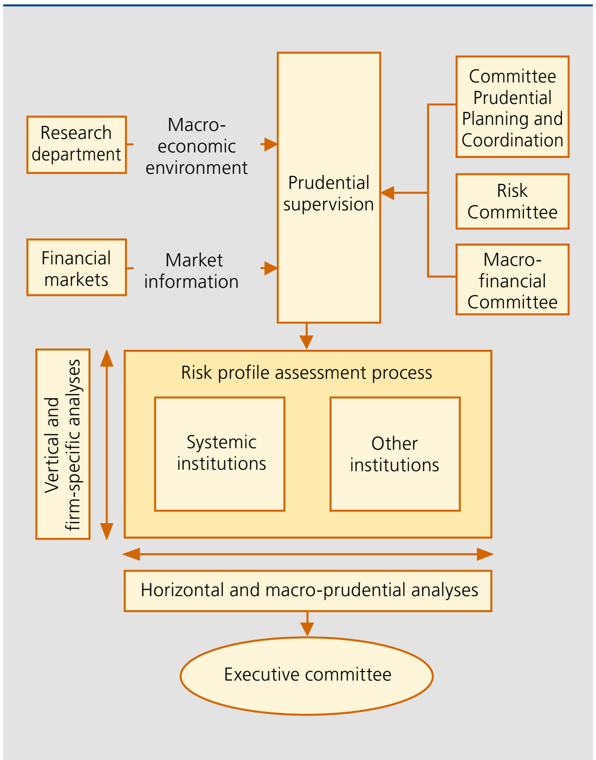
3.1.1 General organisation

The introduction of the 'twin peaks' model and integration of prudential supervision at the Bank have permitted a new emphasis while utilising the opportunities for synergy with other departments of the Bank. As a result of the financial crisis, it seemed necessary to adjust the supervision model. The financial crisis had revealed the limits of the traditional distinction between the micro-prudential supervision of individual financial institutions and macro-prudential supervision centred on the maintenance of financial stability. That distinction is tending to become blurred both in monitoring and in prudential regulations. Regarding risk analysis, the interconnections between institutions and financial markets and the specific role of systemic banks in contagion effects result in strong interactions between the micro- and macro-prudential dimensions. As regards the regulations, the new Basel III framework, which in principle constitutes an instrument for the supervision of individual institutions, also incorporates macro-prudential instruments such as the countercyclical capital buffer, which the authorities are to be able to use to ensure financial stability. The desire to improve the coordination of micro- and macro-prudential supervision was therefore one of the primary motives behind the reforms of the method of organising supervision at both Belgian and European level.

The financial crisis led to a spate of new legislative initiatives, presented in detail in chapter 2.2, which have had a considerable impact on all components of prudential supervision. International bodies, in particular, have strongly encouraged measures permitting tighter, more effective and more reliable prudential supervision. A good example is the November 2010 report by the Financial Stability Board (FSB) on the intensity and effectiveness of the supervision of systemically important financial institutions (SIFIs)[1]. In October 2011, the FSB published a follow-up report setting out additional recommendations on the supervision of SIFIs[2].

The Bank took those recommendations as the basis for adjusting the organisation of prudential supervision. Apart from the organisational changes made by the switch to the 'twin peaks' supervision model, it ensured continuity in the exercise of supervision and in the legal precedents applied. That was guaranteed by the staff of the former Banking, Finance and Insurance Commission (CBFA) who were transferred to the Bank, where prudential supervision was organised according to the 'four-eyes' principle. This model is based on a vertical approach combined with a horizontal approach. The vertical analyses are conducted by operational supervision teams who assess the enterprise as a whole and coordinate the supervision on the basis of a risk analysis and an audit plan for each institution. At the same time, the horizontal analyses of the sector as a whole and of each type of risk considered separately are intended to determine the risks and vulnerabilities in a transverse perspective. In that way, these analyses contribute to the assessment of the risk profile of each individual institution by permitting a better understanding of the complexity of the financial business. This integrated risk assessment process also receives support from the other Bank entities, which contribute their expertise in macroeconomic analysis or their knowledge of financial markets for the benefit of prudential supervision.

(1) *Intensity and Effectiveness of Systemically Important Financial Institution (SIFI) Supervision.*
(2) See the website www.financialstabilityboard.com.



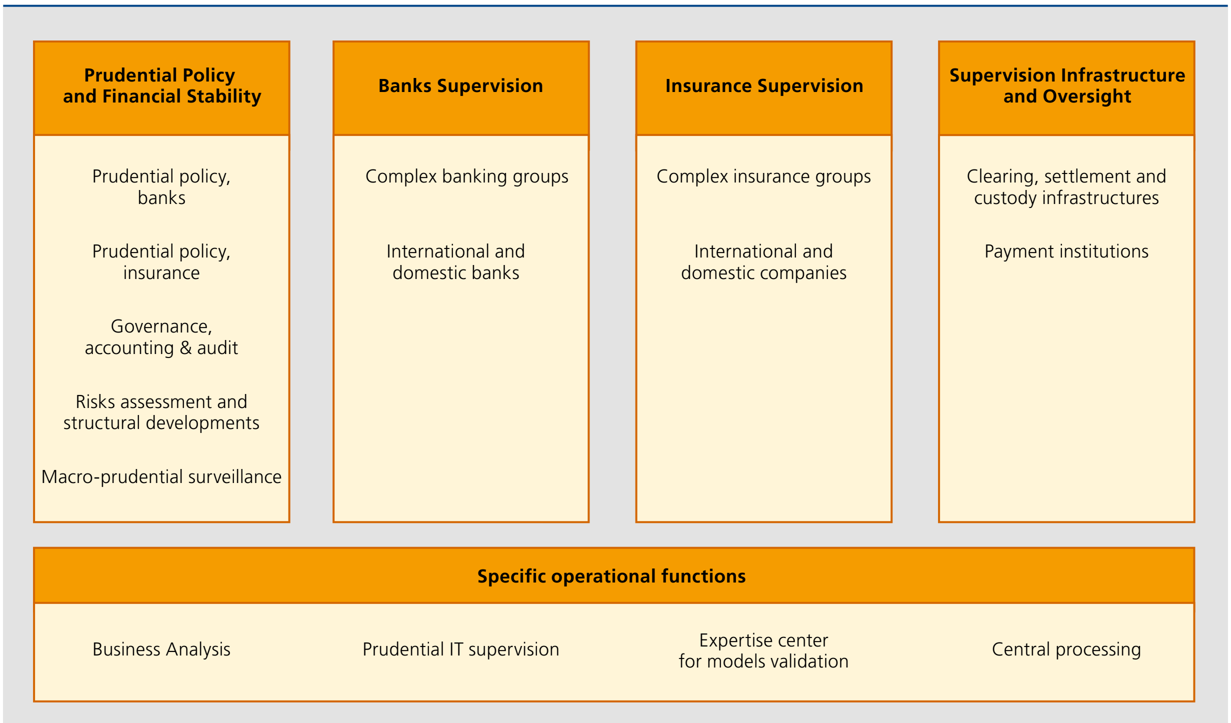
Operational supervision is conducted by the three autonomous services entrusted respectively with the supervision of banks and investment firms, insurance and reinsurance companies, and market infrastructures. These services are responsible for the vertical dimension of supervision. A fifth service is in charge of transverse operational functions for other operational services. This concerns, in particular, the supervision of the IT systems of financial institutions and the validation of the internal models used by banks and insurers to calculate the capital requirements.

To ensure that the new supervision model is effective, three consultation bodies have been created at the Bank. The first, a prudential planning and coordination committee, aims to ensure the good operational organisation of prudential supervision. The second, a risk committee, directs the risk analyses, ensures the consistent application of the regulations, and organises the interaction between the micro- and macro-prudential dimensions of supervision. Finally, the third body is a macro-financial committee, responsible for arranging the interaction between the Bank's prudential functions and its other macroeconomic and financial functions.

The Prudential Policy and Financial Stability service defines the prudential policy, identifies vulnerabilities, particularly systemic ones, and conducts horizontal analyses on the sector and on the various types of risks and their interactions. This service is responsible for the horizontal dimension of supervision.

3.1.2 Supervision methodology

The Bank has introduced a set of instruments for identifying the risk profile of each institution and specifying the method of defining the capital requirements under the second pillar of the Basel framework. In future, these



instruments will be used to supervise the banking sector. They will be extended to the supervision of insurance once they have been adapted to the specific needs of that sector, taking account of the new Solvency II framework.

The second pillar of the Basel II Accords, set out in Title XII of the Bank's regulation of 15 November 2011 on the capital of credit institutions and investment firms, describes the prudential surveillance process, which is to be embodied in an integrated set of instruments based, on the one hand, on the institution's obligation to devise an internal capital assessment process and to set capital targets commensurate with its own risk profile and the quality of its internal controls (Internal Capital Adequacy Assessment Process – ICAAP), and, on the other hand, on the obligation of the supervisor concerned to assess the adequacy and quality of the institutions' capital in the light of their risk profile, and to intervene where necessary by using the various prudential measures at its disposal (Supervisory Review and Evaluation Process – SREP).

The supervisor's role will therefore consist partly in watching over the quality of the risk management and the internal control of institutions, and partly in ensuring that the internal capital adequacy assessment process is satisfactory at all times. These two prudential aims are closely linked and should encourage the dialogue between supervisors and institutions so that, in particular, an adequate solution can be quickly found in the event of any shortcomings.

In order to assess the institution's ICAAP, including the adequacy of its capital, the supervisor must be able to form an opinion on the following points :

– the level of the institution's exposure to all risks identified as material (identification of its risk profile) ;
– the adequacy and reliability of the institution's internal control and its ICAAP ;
– the adequacy of the institution's capital ;
– the quality of its capital, in which context the supervisor must also be able to judge whether capital is the most appropriate means for the institution to guard against any vulnerabilities.

The SREP must be structured consistently for all institutions, regardless of their profile, strategy or management model. The ability to gather and verify all relevant information and the procedures used for analysing risks, based to a significant extent on the findings of the Bank's on-site inspections, are key factors in maintaining the quality and consistency of the prudential assessment process. That requires an efficient risk analysis system which can function as a prudential tool for organising the use of the prudential resources and for planning, formalising and conducting the risk assessments. It provides the structure and sequence of steps in the process of determining the institutions' risk profile. This prudential evaluation process (SREP) can be envisaged as a cycle comprising four separate stages :

– gathering the relevant information ;
– analysing and evaluating the risk profile ;
– summing up the analyses and finalising the risk profile (scorecard system) ;
– defining the prudential measures.

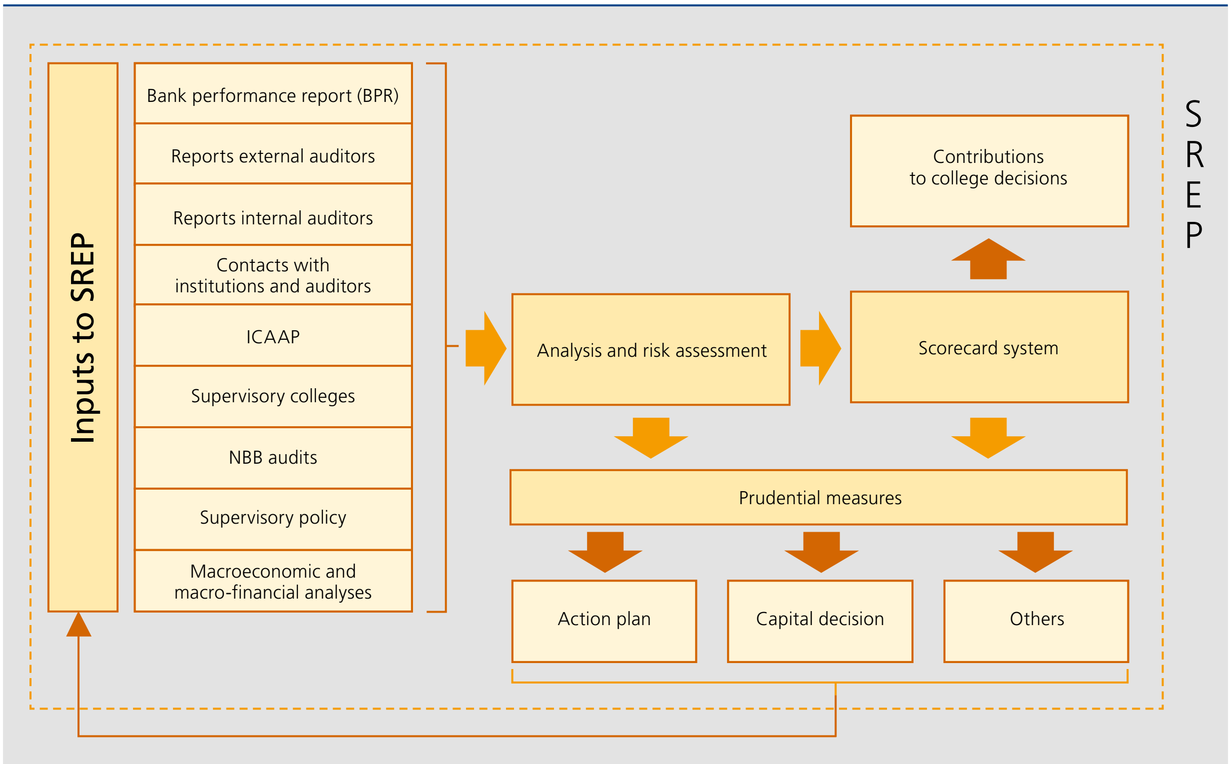
The development of the regulatory prudential framework, and more specifically the implementation of the Basel II Accords and their second pillar, was a good opportunity for reforming and modernising the risk analysis instrument.

Although there has been no change in the primary aims of the previous risk analysis instrument, namely the determination of an institution's risk profile, identification of the prudential priorities and definition of a supervision plan, special emphasis has been placed on the integration and formalisation of the analysis and supervision work. In the process, the new instrument – called the scorecard system – forms the basis for a structured dialogue both with the institutions concerned and with their approved commissioners and the competent supervisory authorities, notably via the colleges of supervisors.

In the new risk analysis instrument, the prudential priorities are defined according to the following three factors : the importance of the institution and its activities for the Belgian financial system, the quality of the institution's shareholdership and the institution's risk profile. There is a score corresponding to each of these factors, namely the impact score, the shareholdership support score and the risk score. An institution's risk score is based on four cornerstones : the general situation of the institution, such as its governance and financial position ; the transverse supervision and support functions, such as the internal audit, compliance and risk management functions ; the risks inherent in the institution's activities ; and the institution's internal process of assessing its capital needs (ICAAP).

The first implementation phase concerned credit institutions and investment firms, and ended with the launch of the application in June 2009. The scorecard system is being extended to include insurance companies from 2012.

The scorecard system was so designed that it also complies with the stipulations of the European Banking Authority (EBA) on joint analysis of the risks of cross-border institutions, as laid down by Article 129(3) of European Directive



2006/48/EC relating to the taking up and pursuit of the business of credit institutions. On the basis of that article and the EBA rules, the Bank developed its policy and methodology for assessing the solvency of credit institutions. In this connection, the European directive provides for a joint decision between the supervisors concerned on the adequacy of the solvency of cross-border credit institutions, both on a consolidated basis at the level of the parent company and in respect of the entities forming part of the group. That assessment has to take account of the risk analysis as indicated by the scorecard, and the appropriateness of the institution's policy and internal process concerning capital adequacy (ICAAP). In this connection, the Bank has told a number of institutions that they should hold more capital than the minimum required by the first pillar. Up to now, such decisions have been expressed in the form of a capital ratio in the strict sense, or Tier 1.

To determine the capital requirement for a credit institution, in particular under Article 129(3), the Bank assesses three elements. First, it looks at the credit institution's ICAAP. In accordance with the regulation on the capital of credit institutions and investment firms, each credit institution is expected to conduct an exhaustive analysis of its risks, to quantify those risks sufficiently prudently and to define a policy on the adequacy of its capital. The Bank assesses the appropriateness of that policy and the risk quantification. Where economic capital models are used to measure the risks, special attention focuses on the diversification effects which the institution takes into account, or on the fact that the amount of capital covering the credit, market and operational risks, as measured by the institution, is not less than the minimum capital requirement relating to those risks. As regards the definition of the internal capital used for the purpose of the ICAAP, the Bank expects institutions to take account only of the existing capital components capable of absorbing losses on the assumption that they remain in business (going concern). The results of the stress tests conducted by the credit institutions form the second element considered by the Bank. One aim of these tests is to ensure that the institution can satisfy the minimum solvency requirements defined by the Bank, and can continue its essential business during periods of recession. The results of the EBA stress tests are used as the benchmark for the institutions taking part. Finally, the Bank also takes account of the results of the risk assessment relating to the business of the credit institutions. Using the scorecard system, the Bank quantifies and assesses all the risks to which the institution is exposed. The quantification of the credit, market and operational risks is based mainly on the minimum capital requirements under the first pillar. The Bank also takes account of an additional amount of capital to cater for risks which are not properly covered by the minimum capital requirements, and more particularly, the concentration risk, the general interest rate risk inherent in non-trading activities, and the institution's strategic or business risk. In its assessment, the Bank also considers the institution's management quality, profitability and potential support by its shareholders.

3.1.3 Monitoring of domestic systemic institutions

One of the lessons of the financial crisis which erupted in 2007-2008 was that the supervisory authorities did not have the tools to tackle the failure of large financial institutions. Many governments therefore felt compelled to intervene to rescue large institutions in distress, in order to avoid the collapse of the financial system.

The crisis therefore highlighted the problem of systemic financial institutions (SIFIs), which – by definition – are institutions whose failure could have a serious impact on the financial system. Financial institutions which are not systemic on a global scale may nevertheless be of systemic importance, at regional (e.g. European or American) or national level. The failure of such institutions would entail substantial costs for the regional or national financial system, forcing the government to intervene to prevent the failure, with the risk of moral hazard mentioned earlier. Consequently, many regional and national authorities are trying to identify which financial institutions are locally systemic, with the aid of methodologies comparable to those devised at global level.

In Belgium, the Bank has designed a methodology for identifying systemically important financial institutions at national level. In accordance with the international framework, the Belgian methodology uses indicators relating to size, substitutability and interconnection, with reference to the domestic financial system. The substitutability indicators reflect the shares of business in the various sectors of the Belgian financial system, while the interconnection indicators are used to assess the extent to which financial institutions have substantial liabilities towards their counterparties in Belgium. At the same time, since systemic importance is hard to measure and some data are not suitable, the method for identifying SIFIs at national level supplements these quantitative indicators with a qualitative assessment by the supervisory authority.

Under the Organic Law, the Bank has to identify the SIFIs at national level and inform the institutions concerned. They are then required to notify the Bank of all proposed strategic decisions. If the Bank considers that the financial institution has an inappropriate risk profile, or if a strategic decision could have an adverse impact on the financial system's stability, the Bank may impose specific measures on the institution concerned. Section 2.1.2 describes the Bank's other powers in regard to these domestic SIFIs.

The FSB recommends that financial institutions of global systemic importance should also be subject to a range of measures designed to improve their resilience and thus reduce the likelihood of serious problems or bankruptcy. In particular, those measures provide for closer supervision, the obligation to increase the ability to absorb losses, the preparation of recovery plans in which the institutions identify and assess potential responses to a range of serious shock scenarios concerning solvency or liquidity, and resolution plans devised by the authorities and specifying the options which – should the occasion arise – would permit the orderly dissolution of the financial institution while minimising the use of public money and the impact on the financial system.

The establishment of recovery and resolution plans is coordinated at international level. The authorities of the G20 countries are currently working, within the FSB framework, on the development of recovery plans with their main cross-border credit institutions. The conclusions of the European Council of 10 May 2010 on crisis prevention, management and resolution also call for European coordination of the recovery and resolution plans.

In Belgium, the Bank works with the domestic SIFIs to guide them in the development of their own recovery plans. It launched a pilot project with guidelines specifying the approach to be adopted in producing such a plan. The recovery plan aims to identify the measures which a credit institution can take to cope with a serious solvency or liquidity shock. The plan, prepared by the credit institution itself, must examine the measures which it can take in a series of extreme scenarios and which enable it to rectify its situation. This plan, which assumes that the government does not intervene, must include measures of last resort, such as the disposal of significant activities or assets. In addition, the Belgian authorities were invited to attend the meetings of the Crisis Management Group of the institutions for which the Bank is the host supervisor. Certain elements of the plans were presented at those meetings. For its part, the resolution plan evaluates the options available to the authorities – and the impediments to their implementation – for managing a banking crisis if the recovery plan has failed to restore a credit institution's soundness. The options considered in the resolution plan aim at the orderly resolution of a crisis. Work on the resolution plans was postponed pending the European developments concerning the crisis management framework, which will have a significant influence on the measures which the authorities can take to manage a banking crisis.

3.1.4 Specific operational functions relating to prudential supervision

As a result of the reorganisation of prudential supervision, a number of transversal functions were brought together in a new service at the Bank, more specifically the prudential supervision of IT, the analysis of quantitative methods, the centralised processing of certain licences, the examination of 'fitness & propriety' and the 'business analysis' function.

Prudential IT supervision aims at conducting a transversal analysis of the IT risks incurred by financial institutions. This supervision mainly takes the form of on-site inspections to assess management, continuity, security, internal control and, where appropriate, outsourcing of IT systems. The reference frameworks used are based on internationally accepted standards, such as the ISO standards. Following the integration of prudential supervision at the Bank, the expertise and resources are also available for the Bank's oversight of payment and securities settlement infrastructures. At supervisory colleges of large international groups for which the Bank acts as home supervisor, meetings focusing on information technology were held for the first time in 2011 with IT supervision experts of the main foreign host supervisors.

From the start of 2011, the Bank also has played an active and leading role in the working group on the security of on-line payments, which reports to the ECB's SecurePay Forum on Retail Payment Security. The working group has concentrated on defining for the euro area supervisory authorities sound practices for securing internet banking transactions, and analysing the various threats associated with such transactions.

In 2011, as in previous years, special attention was given to supervision of continuity and reliability of IT services and to the security of internal IT platforms of banking and insurance groups undergoing drastic reorganisation. After two years without any frauds in Belgium, a surge in e-banking fraud prompted to focus again on the supervision of the security of e-banking services offered by Belgian financial institutions. For that purpose, the Bank works in close collaboration with the Belgian financial sector association (Febelfin) and the federal police's Computer Crime Unit to combat or curtail fraud. As in previous years, the security of Belgium's e-banking services generally ranks as excellent in international terms. However, vigilance is still required in view of the inventiveness of criminals, who are constantly developing and applying new fraud techniques.

The purpose of analysing quantitative methods is to make a detailed appraisal of the risk assessment and risk measurement models used in the insurance and banking sectors and in market infrastructures for all types of risk (life and non-life risks, market risk, credit risk, operational risk etc.). To that end, the Bank assesses the appropriateness of the quantitative aspects of risk management, mainly via on-site inspections by auditors specialising in these techniques jointly with "generalist" auditors examining the more qualitative aspects. These on-site inspections of quantitative methods, while forming part of conventional auditing work, concentrate on validating the internal models used by supervised institutions for determining the regulatory capital requirements. Actually, the new legislation on the supervision of credit institutions and insurance companies expands the scope for using internal models approved by the supervisor, replacing the more standard 'one size fits all' methods.

In 2011, the first priority for the insurance sector was the preparation for entry into force of Solvency II, which will also permit the use of internal models for regulatory capital requirements. For that purpose, the Bank has continued to develop its expertise and methodology for supervising these models, e.g. by conducting a general survey of models for non-life risks (including natural disasters), a horizontal analysis of the technique of replicating portfolios, and an in-depth study of the economic scenario generators. Assignments were carried out in connection with the pre-application of internal models under Solvency II, and for the implementation of rules permitting exemption from an additional provision for the interest rate risk on life insurance offering a guaranteed yield and for industrial accident business.

Particular attention is given to the level playing field in Europe, using information obtained by participating in an informal working group of quantitative experts in the European Insurance and Occupational Pensions Authority (EIOPA), and by carrying out various assignments jointly with other European supervisors.

In the banking sector, a large number of dossiers were submitted in 2011 for the use of internal ratings-based (IRB) credit risk models; it related to new models, to the follow-up of terms and conditions imposed in the past, or to the extension to a Belgian subsidiary of models used at group level.

Furthermore assignments relating to market activities were carried out, partly as a result of the new regulations (Capital Requirements Directive – CRD III), stipulating that new models must be developed by the end of 2011 for other types of risk (stressed VaR, incremental risk charge and comprehensive risk method). In addition, the Bank prepared for the introduction of the regulations on counterparty risk (credit valuation adjustment) which will enter into force at the end of 2012. Finally, other assignments were carried out relating to economic capital and operational risk.

Since 1 April 2011, the Bank has conducted a centralised and transversal processing of institutional operating dossiers of undertakings transferred to its prudential supervision. In addition, a new environment necessary for the new relationship between the Belgian Financial Services and Markets Authority (FSMA) and the Bank, also forms part of those transversal operational functions known as 'central processing'. They result from the 'twin peaks' model introducing a dual supervision model based on two supervisors responsible for specific tasks. More particularly, the transversal functions concern the processing of the following:

- 'fit & proper' dossiers, concerning professional integrity, based in particular on the absence of any breach of the relevant financial legislation cited in Article 19 of the Banking Law and the appropriate experience of the directors of institutions subject to prudential supervision. It involves the use of an extensive questionnaire which institutions have to submit for each candidate. In order to improve the procedure, an analysis of the various stages has been performed;
- notifications of activities under freedom to provide services by institutions subject to prudential supervision in the European Economic Area (EEA) and, in some cases, outside it;
- dossiers of approved external auditors and actuaries;
- contacts between the FSMA and the Bank, in the form of requests for opinions, communication or information related todossiers of supervised institutions.

In addition, this "centralised processing" unit acts as system owner and IT correspondent for the IT applications of prudential supervision, for which the emphasis in 2011 was on ensuring continuity following their transfer to the Bank. Finally, it is the first point of contact or guidance for any institution applying for a licence.

Lastly, the purpose of business analysis is to screen and if necessary improve the processes in the various prudential supervision services, in particular by acting as an intermediary to the Bank's IT department. In 2011, these analyses mainly focused on a tstock-taking exercise of the various information flows, on optimising the 'fit & proper' process and on defining user requirements for new releases of reporting tools.

3.1.5 Deposit guarantee system and contribution to financial stability

The Royal Decree of 14 November 2008, amended by the Programme Law of 23 December 2009, modified the mechanism of contributions levied on financial institutions in connection with the deposit guarantee scheme. The Royal Decree of 14 November 2008 raised the guarantee to € 100 000 per depositor, while also establishing the Special Protection Fund for deposits and life insurance, financed by annual contributions amounting to 0.31‰ of the total deposits eligible for repayment. Article 169 of the 2009 Programme Law later increased the annual contribution payable to the Special Fund to 0.15%.

The sector contested this mechanism and therefore tried to develop an alternative proposal. Moreover, an action for annulment was brought before the Constitutional Court, concerning both the annual contribution and the one-off initial fee. In regard to the annual contribution, the plaintiff argued in particular that the contribution of the banks was calculated solely on the basis of deposits covered by the protection system, and that the plaintiff was therefore disproportionately affected compared to financial institutions which are wholly or largely funded in other ways. Apart from this alleged breach of Articles 10 and 11 of the Constitution concerning the principle of equality and non-discrimination, the plaintiff also claimed a violation of Articles 170 and 172 of the Constitution whereby the King has no power to determine an essential element of taxation. While the Constitutional Court ruled that the contribution and initial fee were not a tax but a payment not covered by Article 172 of the Constitution, it nevertheless decided that the legislature must respect the principle of equality and non-discrimination. In particular, the Court considered that account must be taken of the risk that the government would actually have to intervene, and that the deposits placed with a credit institution were no indication of that risk. The Constitutional Court therefore annulled the provision relating to the annual contribution. However, the effects of the annulled provision were maintained until 31 December 2011 to allow the legislature to amend the contested provision.

In that connection, the Bank – and before it the Committee for Systemic Risks and Systemic Financial Institutions (CSRSFI) – responded to a number of requests from the Minister of Finance concerning this case. First, the CSRSFI examined the alternative proposal produced by the sector. This was based on a set of fixed contributions divided into three components, namely a contribution under the deposit guarantee system, a financial stability contribution and a financial activity tax. The sector proposed that the contributions to the deposit guarantee scheme and the financial stability contributions should both be weighted on the basis of risk factors.

The CSRSFI stated its preference for a two-part contribution. The first part is based on the deposit guarantee system for which the contributions would be risk-weighted. For that purpose, the CSRSFI decided in favour of a scheme comparable to the system proposed by the European Commission (EC) in its proposal for a directive, in order to align the Belgian system straightaway with the European developments. Moreover, to take account of the risks connected with the funding structure of credit institutions, and more particularly their potential dependence on the wholesale funding markets, the CSRSFI advocated introducing a financial stability contribution based on that wholesale funding and intended to build up a resolution fund.

The Minister of Finance therefore asked the Bank to submit a proposal for laws and regulations addressing the objections of the Constitutional Court and introducing a two-pillar system generating amounts equivalent to the levies in 2011. The draft texts were passed to the Minister of Finance in September 2011. They were in three parts. The first text is a draft law introducing a financial stability contribution and amending the calculation of the contribution to the deposit guarantee scheme for Belgian credit institutions by adding a risk weighting. The second is a draft Royal Decree developing the technical criteria for calculating the contribution to the deposit guarantee scheme. Finally, the third is a draft Royal Decree on the organisation of the resolution fund responsible for collecting the financial stability contributions. These texts formed the basis of the law of 28 December 2011 introducing a financial stability contribution and amending the Royal Decree of 14 November 2008. This law introduces a resolution fund financed by a financial stability contribution equivalent to 3.5 basis points of the wholesale funding, calculated as the total liabilities less the guaranteed deposits and the capital. This new contribution is due from all credit institutions incorporated under Belgian law, for which the law also introduces a risk-based system for the calculation of the contribution to the deposit guarantee scheme[(1)]. In contrast, in the case of investment firms and branches of non-EU banks subject to the deposit guarantee system in Belgium, contributions remain risk-insensitive.

3.2 Prudential supervision of banks

In 2011 the prudential supervision of banks was dominated by the financial crisis, which affected all institutions in varying degrees. Surveillance of liquidity and solvency was greatly tightened up by supplementing the regulatory periodic reporting with ad hoc reporting, the content, scope and frequency of which is determined according to the evident or assumed risks. Thus, systemic banks now have to inform the Bank daily of their liquidity position (see also section 3.2.3). Other reporting concerns their exposure to specific asset classes such as government bonds or structured credit.

In the year under review, application of the new prudential rules on remuneration policy also became reality. The banks' existing practices were examined in the light of the new rules, and a number of banks had to make significant changes to their policy.

The application of the new SREP methodology as described in section 3.1.2 of this Report will give the supervisory authority a powerful tool for charting and evaluating the risks facing the banks, and – where necessary – stipulating additional capital to cover them. This risk assessment and the decision on the capital, which must take place at least once a year, will form the basis for a continuous prudential dialogue with the banks, the aim being to achieve better risk control.

3.2.1 Actions concerning the Dexia group

Faced with mounting problems in obtaining adequate funding for its activities on the market, on 10 October 2011 Dexia announced its decision to implement a global restructuring plan, the central feature being the sale of most of its operating subsidiaries and the obtaining of a new State guarantee for its funding.

The persistence of the financial crisis which, since 2008, has affected the financing of first the banks and then governments, has had a serious impact on the liquidity situation of the financial markets, severely testing Dexia's business model. That model was based on the principle that, thanks to its high credit rating, the group did not need to offer collateral in order to secure constant access to the interbank market, which was very liquid at that time; this therefore enabled Dexia to grant long-term loans, primarily to public authorities but also to businesses and households, and furthermore to build up a substantial bond portfolio. Consequently, a fundamental change in the strategic choice of such a business model cannot be made in a short space of time. Furthermore, another part of the funding came from the group's retail bank, Dexia Bank Belgium, which granted intra-group loans to entities which had no access to the deposit market.

(1) See the Special Protection Fund website (www.bijzonderbeschermingsfonds.be) for a summary of the deposits covered by the guarantee system.

Since, in the autumn of 2008, Dexia had to seek State aid to resolve its serious liquidity problem, the EC imposed a restructuring plan to achieve substantial reductions in the size of its balance sheet and in its short-term funding. The EC approved this plan on 26 February 2010, and in 2011 Dexia proceeded to implement it, but the persistence of the crisis and the absence of investors meant delays in selling off the bond portfolio, and made it virtually impossible to sell certain entities.

Since 1 April 2011, as the consolidating supervisor of Dexia, the Bank in collaboration with its counterparts in the core college of supervisors, namely the French and Luxembourg supervisory authorities, and the general college, namely all the European and non-European supervisory authorities of Dexia subsidiaries or branches, has kept a close watch on the essential improvement in Dexia's risk profile in the course of the group's restructuring. In this connection, the supervisory authorities conducted an overall risk assessment which led to a decision on the capital of the financial holding company Dexia SA/NV and its component entities. The risk analysis showed that the liquidity risk, the financial position of the reference shareholders, the market risk and the revised business plan in the light of the financial crisis were the main risks facing the group. The college of supervisors formally notified Dexia of this assessment and of its capital decision.

The escalating sovereign debt crisis had a severe impact on Dexia as a specialist in lending to public authorities. At the same time, the financial markets increasingly shunned the planned asset sales intended to reduce the need for funding. The assets could only be sold at rock-bottom prices entailing heavy losses. Moreover, falling interest rates led to a significant increase in the cash collateral required by counterparties in interest rate hedging operations. In these circumstances, and in order to anticipate any further escalation of the crisis, the supervisory authorities demanded, in the second quarter of 2011, that Dexia should immediately start work on an overall emergency plan which, if the situation so required, comprised possible scenarios for breaking up the group, sheltering customer deposits and transferring the illiquid assets to a separate entity.

Although Dexia was able to continue to reduce its risks, thanks to the speedier sale of certain assets such as the American financial products portfolio at the beginning of the summer, a series of factors made the financial markets increasingly doubtful about the success of the Dexia group restructuring. A succession of negative press articles reported delays in implementing the Dexia restructuring plan approved by the EC, the threat of downgrading of the credit rating owing to Dexia's exposure to Greece, the group's low profitability and the financial situation of the reference shareholder, the Municipal Holding Company. The mounting mistrust led to a dramatic fall in share prices and rising credit default swap premiums, which progressively blocked Dexia's access to the interbank market.

To halt any further deterioration in Dexia's liquidity position, the Bank instructed the group, at the end of August 2011, to implement its emergency scenarios without delay by executing the accelerated sale of the bond portfolio and initiating the process of selling off a number of the group's major operating entities.

The decision by the credit rating agency Moody's, at the beginning of October 2011, to place the group's long- and short-term ratings under review once again negatively impacted Dexia's ability to raise unsecured short- or medium-term funding, at a time when the group faced customer deposit withdrawals. When the liquidity forecasts showed that Dexia could no longer avoid asking for emergency finance from the central banks, the only option was to dismantle the group.

Over the weekend of 9 and 10 October 2011, the board of directors presented its overall restructuring plan to the Bank. That plan involved a number of strategic decisions, including the sale of the group's main operating entities. In particular, Dexia Bank Belgium and its subsidiaries – except Dexia Asset Management – were sold to the Federal Participation and Investment Company (FPIC), acting on behalf of the Belgian State. Under the plan, the residual Dexia group will also receive financial guarantees from the Belgian, French and Luxembourg governments up to a maximum of € 90 billion. Dexia immediately started talks with international investors interested in acquiring Dexia Banque Internationale à Luxembourg, on which a memorandum of understanding was signed on 20 December between on the one hand, Precision Capital, a Qatar investment group and the Luxembourg State, and on the other, Dexia SA/NV. In France, negotiations began with the Caisse des Dépôts et Consignations and the Banque Postale with a view to concluding an agreement on the financing of the French local authorities, which would involve the partial sale of Dexia Municipal Agency, a group Société de Crédit Foncier which refinances loans to local authorities by issuing covered bonds.

The other Dexia group entities, namely Denizbank, RBC Dexia Investor Services and Dexia Asset Management, are also to be sold to foreign investors in the near future.

The Bank declared that it had no objection, in principle, to this restructuring plan which, at the end of the period under review, was yet to be approved by the EC. On 17 October 2011 the EC decided to start a formal investigation procedure into the sale of Dexia Bank Belgium to the Belgian State. To safeguard financial stability, it gave its provisional approval, i.e. for a six-month period.

On 21 December the EC also provisionally approved the State guarantee for the financing of Dexia SA/NV and Dexia Crédit Local, although it set a maximum of € 45 billion pending a restructuring or liquidation plan to be submitted (ik schrap deze zinsnede omdat de staten het plan indienen) to the EC by no later than 20 March 2012. The guarantee will be limited to securities with a maximum maturity of three years, issued before 1 June 2012.

The Bank is now making sure that the financial and operational risks inherent in the implementation of the restructuring plan – and in particular the separation of Dexia Bank Belgium from the residual group – are identified and properly managed. A transition committee comprising representatives of the FPIC, the residual Dexia group and Dexia Bank Belgium, is responsible for maintaining operational continuity and ensuring the orderly execution of the operations severing the links between the residual group and Dexia Bank Belgium.

3.2.2 Liquidity management supervision

The acute liquidity shortages which the Dexia Group experienced again in 2011 once more highlighted the crucial importance of liquidity management by credit institutions and the need for close monitoring and regulation of this aspect by the supervisory authority.

On the basis of an analysis of the prudential approach to liquidity risk, conducted in the wake of the financial crisis, and following consultation between supervisory authorities at international level, the Belgian prudential supervision authority decided, in 2009, to tighten up its liquidity policy still further, in line with earlier initiatives. In practice, it introduced stress test ratios for observing the liquidity position of credit institutions. The aim of these ratios is to reveal the extent to which the liquidity position of the institutions concerned can withstand the impact of certain exceptional circumstances defined by the supervisory authority. Those ratios are calculated on the basis of the periodic liquidity reports submitted by the institutions concerned to the supervisory authority. In these reports, the institutions have to declare the amount of the buffer comprising liquid financial assets at their disposal on the reporting date, and the projected and potential cash flows for the next twelve months. These standard reports form the basis for calculating observation ratios, taking account of assumptions adopted by the supervisory authority and applied in the same way to all Belgian credit institutions. These assumptions are comparable to those used by foreign supervisory authorities.

In addition, the Belgian supervisory authority has updated its qualitative requirements for the management of liquidity risks in accordance with the latest international recommendations. In September 2008, the Basel Committee had published new qualitative guidelines for the liquidity management of credit institutions [1], concentrating on the liquidity management dimensions brought to the fore by the financial crisis, such as the institutions' contingency funding plans, the impact of complex financial instruments on the liquidity position, the development of stress tests for the liquidity position of institutions, the liquidity risks associated with off-balance-sheet vehicles, and other contingent liquidity exposures, cross-border liquidity flows and the management of liquidity positions in various currencies, and coordination and communication between national supervisory authorities and central banks. Finally, monitoring of the liquidity position of Belgian financial institutions was intensified, with an increase in the frequency of liquidity reporting and shorter reporting deadlines.

The financial crisis also led to a fundamental shift of focus in the international debate between supervisory authorities regarding liquidity standards. In particular, the Basel Committee and the Committee of European Banking Supervisors (CEBS), the forerunner of the EBA, took steps towards broad harmonisation of liquidity policy between the national supervisory authorities. To that end, these international bodies published the harmonised qualitative guidelines mentioned above, which all credit institutions must respect, and in December 2010 they concluded an agreement on the worldwide introduction of two uniform quantitative standards (the Basel III liquidity standards) in order to reduce the maturity mismatch between bank assets and liabilities. The first standard, the liquidity coverage ratio (LCR), will oblige credit institutions to hold sufficient high quality liquid assets – capable of being used in repo transactions on the money market or with central banks – in order to cope with a crisis which would seriously impede their refinancing capacity for a period of one month. The LCR is intended to mitigate short-term liquidity risks and is comparable, in terms of methodology, to the regulatory ratios which the Belgian supervisory authority uses to observe the liquidity position of credit institutions, although it employs other parameters, definitions and assumptions for the stress scenario. This ratio will be supplemented by the introduction of a net

(1) *Principles for Sound Liquidity Risk Management and Supervision*, Basel Committee on Banking Supervision, September 2008.

stable funding ratio, intended to ensure that the bank's illiquid assets and potential off-balance-sheet liabilities are financed by funding regarded as stable. The purpose of introducing this second liquidity standard is to improve the structural liquidity position of the banks, to prevent long-term illiquid assets from being financed to an excessive extent by very short-term funding. Preparations have begun at European level for the application of the Basel Committee ratios to all European credit institutions. Quantitative impact studies (QIS) have been conducted to analyse the impact of the implementation of these ratios. For more details, see Box 4 in section 2.2.2.

In the light of these international developments and with a view to the introduction of the LCR from 2015 onwards, the Belgian supervisory authority therefore decided that, from the beginning of 2011, the stress test ratios for observation of the liquidity position would be adopted as the mandatory liquidity limits for all Belgian credit institutions. In some cases, the supervisory authority may grant waivers for institutions whose regulatory liquidity ratios exceed these regulatory limits, if appropriate by imposing supplementary conditions, such as more frequent reporting or the activation of the institution's contingency funding plan. That option might be used, for example, in the case of an institution deploying its liquidity buffer in extreme circumstances, or in the context of a specific business model whereby the standard would be structurally exceeded. The analysis of developments concerning this regulatory ratio, presented in section 1.2.1, shows that from 2009 Belgian credit institutions gradually improved their short-term liquidity position in anticipation of the imposition of these ratios from 2011. However, that gradual improvement was interrupted by the escalation of the sovereign debt crisis which, in particular, restricted access to long-term funding.

Use of this standard did not prevent the Bank from continuing its individual prudential measures in respect of institutions with an excessive liquidity risk or inadequate liquidity management, and maintaining very close monitoring of the liquidity position of certain financial institutions. In Dexia's case, though the existing liquidity buffers were initially sufficient to permit restructuring of the business on the planned timescale, the deterioration in the group's liquidity position was one of the factors prompting the Bank to require a faster reduction in the risk profile (see Box 2, section 1.2.1). In addition, the Bank continued to support and play an active part in the international consultations on the introduction of the aforesaid harmonised quantitative standards for liquidity risk.

3.2.3 Supervision of cross-border banking groups

Banking supervision is increasingly taking place in an international context, especially in the case of cross-border banking groups. Since the supervision of individual banks is currently still the responsibility of the national supervisory authorities, colleges of supervisors comprising the consolidating supervisory authority ("home supervisor") and the supervisory authorities of the subsidiaries or significant branches ("host supervisor") are accorded a coordinating role, with the specific task of not only exchanging all relevant information but also conducting joint risk assessments and taking joint decisions on the adequacy of the capital of the cross-border group and its components. When the Bank acts as the home supervisor, its supervision focuses on the following aspects:

- steering the college of supervisors in accordance with European and international rules and the observed best practices;
- conducting – for the first time in 2011 – a joint risk assessment and a joint ICAAP assessment and arriving at a joint capital decision;
- establishing the infrastructure to prepare for crisis management in the event of a serious crisis;
- extending the sphere of activity of the college of supervisors to include new topics such as macro-prudential supervision, IT risks and non-financial risks;
- conducting (EBA) stress tests.

When the Bank acts as host supervisor for a significant branch or subsidiary, it concentrates on the following topics: contributing actively to the work of the college and defining the supervision policy for the group, as a member of the (core) college of supervisors, and taking an interest in all aspects which determine the position and risks of the host country entity within the group, such as intra-group exposures and the transfer of assets and liabilities. Notwithstanding the increasing role of the colleges of supervisors and the coordinating function of the home authority, the host authority nevertheless carries ultimate responsibility for the supervision of subsidiaries of foreign groups.

Some Belgian banking groups, such as KBC and Dexia, benefited from public intervention in the form of a capital injection or guarantees covering assets or liabilities, and must now implement restructuring plans imposed by the EC. Those plans, which are far from easy to carry out in view of the persistent financial crisis, have a substantial influence on the policy and financial position of those institutions. Although the banking supervisor is not involved in these restructuring plans, the Bank keeps a close eye on their execution, and in certain cases has to give its approval, namely where strategic decisions are concerned.

3.2.4 College of supervisors

The Bank exercises prudential supervision on a consolidated basis over the Dexia and KBC cross-border banking groups, for which it is the home supervisor. That consolidated surveillance does not mean that the Bank supervises each individual company included in the consolidation scope of the banking group concerned. In the case of regulated companies, it means that each supervisory authority remains responsible for supervising those companies on an individual, sub-consolidated basis. As the home supervisor, the Bank is responsible for steering and coordinating the colleges of supervisors for Dexia and KBC. The supervision of those international banking groups is conducted on the basis of Memoranda of Understanding (MoUs) between the supervisory authorities, which define the collaboration procedure and practical arrangements.

The general multilateral college supervising Dexia, which meets once a year, comprises the authorities of eleven European and four non-European countries. The Bank together with the French Autorité de controle prudential (APC) and the Luxembourg Commission de surveillance du secteur financier (CSSF) forms the core college that meets each quarter. The Bank is the consolidating supervisor for the whole Dexia group, while the ACP and the CSSF are the supervisory authorities responsible respectively for the French and Luxembourg banking sub-groups.

The general multilateral college supervising KBC meets once a year and comprises the authorities of ten European and four non-European countries. In 2011, the core college of KBC consisted of supervisory authorities from nine European countries (Bulgaria, Czech Republic, Germany, Hungary, Ireland, Luxembourg, Poland, Slovakia and the United Kingdom). However, that number will decline as KBC executes its divestment plan approved by the EC.

The colleges are intended to improve the supervision of cross-border banking groups. They act as a forum enabling the supervisory authorities to consult one another in order to gain a more accurate picture of the risk profile of the banking group, its risk management and risk control, and hence to coordinate the prudential measures of the various supervisory authorities. The tasks of the college of supervisors include exchanging information, agreeing on the allocation of tasks and the delegation of responsibility, and defining prudential supervision programmes.

In accordance with the new European regulations, from 2011 onwards the colleges are to conduct a joint risk assessment and issue a joint capital decision on each cross-border banking group. This assessment process, the SREP, is to lead to a joint decision on the adequacy of the capital according to the risk profile of the banking group in question, and a decision on the minimum capital that each group must maintain, on a consolidated basis and at the level of its European subsidiaries, in addition to the regulatory amount calculated under pillar 1. This risk assessment and the capital decision must then form the basis of the joint home host supervisory plan for 2012.

Under this new European legislation, the Bank, as the home supervisor of Dexia and KBC in the college of supervisors concerned, is thus responsible for identifying and assessing the risks facing each group, then verifying whether the group and its component entities have sufficient capital to cover those risks. This joint exercise does not alter the fact that each supervisory authority remains responsible for the prudential surveillance of the entities subject to its supervision.

The process leading to a joint risk assessment and a joint capital decision by the college for the two banking groups was an exercise which dominated the college activities in 2011.

For both banking groups, the Bank produced a draft report setting out the risk assessment on a consolidated basis. For that purpose, it used an internal risk analysis system of assessing, by means of a score card, the solvency, liquidity and profitability of the banking group, and the risks inherent in the group's activities, such as credit risk, market risk, interest rate risk and operational risk, by a quantitative measurement of the risks and a qualitative measurement of their management. The Bank also assessed the banking group's governance and risk and control functions, such as the internal audit, risk management and compliance. The host supervisors were asked to carry out the same exercise for the entities subject to their supervision, in order to take account of their own risk assessment in the preparation of the draft report setting out the consolidated risk assessment.

This report on the risk assessment was discussed in detail and then approved by the college of supervisors of the banking groups concerned. On the basis of that risk assessment and the process of determining and assessing the capital adequacy (ICAAP), the college discussed the draft capital decision at consolidated level. It reached agreement in principle on the capital decision to be adopted on a consolidated basis for the banking group concerned. In regard to the capital decision to be adopted at the level of the local European entities, the host supervisors explained their proposals to the college.

For the two banking groups, the Bank formalised the joint risk assessment and joint capital decision at

TABLE 8 CREDIT INSTITUTIONS SUBJECT TO THE BANK'S SUPERVISION

	Home	Host	Solo
Large institutions	DEXIA	BNP Paribas	
	KBC	ING	
Other	5 (1)	20 (2)	8

Source: NBB.
(1) Of which three with a college of supervisors organised by the Bank.
(2) Of which five with a college of supervisors in which the Bank participates as host authority.

consolidated level by asking the host supervisors for their formal approval at the end of the college meeting, and requesting that they pass on the draft capital decisions produced by the host supervisors for the local European entities.

The European legislation stipulates that the entire procedure must be completed within four months following communication of the risk assessment to the host supervisors, though that time limit was extended to six months until 31 December 2012. For both the Dexia group and the KBC Group, the joint capital decision was delivered on time.

Once they became final, this joint risk assessment and joint capital decision were communicated by the Bank, as the home supervisor, to the institution concerned, together with a reasoned decision. In order to ensure a due process, the group's management had already been informed orally, during the decision-making process, of both the methodology and the focus of this work.

The work of the college concerning Dexia and KBC also covered the stress tests and risk assessments conducted by the EBA. In addition, for KBC a special college was created to deal with that group's use of the Advanced IRB approach for calculating the capital requirements necessary for covering the credit risk.

As host supervisor of the ING and BNP Paribas groups, the Bank played an active part in the core colleges of each of those two groups. This work by foreign colleges of supervisors concerned in particular the joint risk assessment and joint capital decision relating to these cross-border groups, and topics such as internal governance and non-financial risks.

3.2.5 Cross-border stability group

On 1 March 2011 the CBFA and the Bank held the inaugural meeting of the cross-border stability group (CBSG) for Dexia, attended by representatives of the banking supervisory authorities, central banks and finance ministries of Belgium, France and Luxembourg. The inaugural meeting of the CSBG for KBC took place on 1 April 2011, with representatives of the banking supervisory authorities, central banks and finance ministries of Belgium, Bulgaria, the Czech Republic, Hungary, Ireland, Luxembourg, Poland and Slovakia.

The organisation of these CBSGs conformed to the EU Council's aim of having a CBSG for all large European financial groups by mid-2011. The institutional framework of these CBSGs is laid down in the memorandum of understanding (MoU) dated 1 June 2008 on cooperation between financial supervisory authorities, central banks and finance ministries of the EU on cross-border financial stability. This MoU provides for the devising of crisis management procedures based on the legal powers of the individual authorities and on existing mutual networks (including the colleges of supervisors).

At the CBSG meetings for Dexia and KBC, there was a report on the European and international initiatives relating to crisis management. The banking supervisory authorities concerned explained the systemic importance of the banking group, discussed potential crisis triggers and dealt with the development of a recovery plan. The central bankers and finance ministries concerned discussed the crisis resolution arrangements for the various countries.

3.3 Prudential supervision of insurance companies

At the start of the work on transposing the Solvency II Directive which, in principle, is to be completed by 31 October 2012 for entry into force on 1 November 2012, it was decided to completely redraft the law on the prudential supervision of insurance companies. That redrafting prompted the Bank to re-examine the provisions of the current legislation. Some particularly important or fundamental aspects relating to the prudential legislation, such as the submission to the Bank of accounts drawn up in accordance with the Belgian accounting standards (Belgian GAAP), the role of the approved commissioners and the maintenance of a maximum interest rate for life insurance, are currently being analysed. The Bank is exploring the various options and will conduct ad hoc consultations on its proposals. It is also addressing these issues in its quarterly contacts with the sector. In addition, the Bank has set up a Solvency II discussion forum in order to facilitate informal exchanges of ideas on subjects important to the insurance sector and on the main developments in European legislation concerning Solvency II. This forum meets every two months and is attended by the directors of six large Belgian insurance companies, including an insurance holding company

3.3.1 Prudential supervision measures

In a context of severe financial market tension, the supervisory authorities have kept a close watch on how these exceptional circumstances are affecting the financial position and results of the supervised institutions. One of their specific concerns related to the implications of the downgrading of the ratings of a number of countries. In particular, the Bank conducted a survey on securities issued by peripheral euro area countries and held by insurance companies, and at the same time paid special attention to insurance company exposures to financial institutions.

The information thus obtained was used for the purpose of horizontal analyses and formed the basis for sectoral consultations on the involvement of the private sector in the second assistance programme for Greece. The information was also passed on to EIOPA in connection with the collection of data at European level. This should enable EIOPA to obtain a clearer picture of the financial situation of the large insurance groups in Europe, and to devise strategic options to cope with a possible emergency situation.

These analyses and surveys did not reveal any insurmountable situation requiring immediate action in the form of a recovery or financing plan. Nevertheless, the Bank is monitoring developments in the situation very closely, and making the necessary preparations to permit rapid intervention in institutions whose financial situation is ailing. In particular, scenarios have been developed for analysing the impact of financial market stress on the financial position of a number of insurance companies. Large insurance groups also contributed to the design of a stress test by EIOPA (see section 1.2.2).

In connection with its supervision of insurance companies, the Bank granted licence applications submitted by insurers for the pursuit of activities in new insurance classes, and also granted permission for the opening of branches. In addition, it noted the intention of some companies to engage in business under the rules on freedom to provide services, whereby the supervisory authorities of the country where the services are provided must be informed of the intentions of the companies concerned. The Bank approved mergers and disposals, changes to the shareholdership of companies and the appointment of new directors.

Owing to the persistent financial market tension, a number of supervised institutions struggled to respect the required solvency margin, and prudential measures had to be taken to deal with the situation. A number of businesses underwent restructuring or reorganisation. The Bank ensured that these operations went smoothly.

The forthcoming adoption of a new prudential regime was another focal point. The results of firms taking part in the fifth quantitative impact study under the Solvency II project (QIS5) were analysed in detail (see Box 3 in section 1.2.2). The conclusions of that analysis are satisfactory, but firms which did not participate need to be made more aware that the new regulatory framework will soon come into force, and that it is not advisable to continue postponing the acquisition of the necessary expertise on the subject.

Finally, the Bank also examined dossiers concerning the models and exemptions relating to the additional provision for the interest rate risk, both for life insurance activities offering a guaranteed yield and for workers' compensation insurance. For the dossiers on models, the analyses produced very satisfactory results, as all the models submitted achieved a high, or even maximum, score. In the case of the exemption dossiers, the situation is likewise positive, and most firms submitting a dossier qualify for substantial or full exemption.

3.3.2 Pre-application process for internal models

In the context of pillar 1 of the new prudential framework, Solvency II, insurance companies can calculate their capital requirements on the basis of an internal model provided they have the supervisor's authorisation. Insurance companies were asked to take part in a pre-application process so that the preliminary work could begin on the validation of applications for the use of internal modes (application process).

In 2011, the Bank started work on the pre-application process for internal models in the case of companies which had submitted a dossier in response to the circular of 18 February 2011 and been authorised by the Bank to take part in the pre-application process. The criteria for determining whether a company qualified for the pre-application stage were defined with reference to the criteria proposed in the guidance issued by the Committee of

European Insurance and Occupational Pension Supervisors (CEIOPS), the forerunner of EIOPA: 'CEIOPS Level 3 guidance document on Solvency II: Pre-application process for Internal Models' dated March 2010. Altogether, in response to the pre-application circular, 11 dossiers were submitted to the Bank and a further four companies have indicated that they will probably submit one in 2012.

The Bank also contacted certain companies which it had expected to submit a pre-application dossier but which had not done so. These are companies belonging to complex groups, with a large market share or engaging in specific activities for which the standard formula seems inappropriate owing to the second criterion in the CEIOPS guidelines, namely the systemic character of the companies in question.

On the basis of the dossiers received, the Bank determined which companies are accepted for the pre-application process. The companies' internal models vary in the degree to which they conform to the Solvency II Directive. Companies which have not been approved by the Bank for participation in the procedure will have to supplement their dossiers and resubmit them later, once they have adapted their internal models in line with the directive's requirements.

The analyses began after receipt of the dossiers on 30 April, and most companies were contacted for the purpose of discussing the dossiers submitted. In addition, the colleges of supervisors set up to coordinate the supervision work incorporated the pre-application process in their activities. Where appropriate, a college of supervisors was set up and brief on-site inspections have already been conducted on specific subjects (market risk, replicating portfolio, non-life internal models, natural disasters), or will begin shortly. This work will continue in 2012 and will be extended to all companies accepted for the pre-application process.

Having carried out this work, the Bank found that companies have already made significant progress, but it also identified a number of major challenges. The findings discussed in reports to the companies mainly concern the implementation plans, methodology and detailed arrangements for the use of the internal models. They are discussed at meetings of the Solvency II Forum.

3.3.3 Supervision of insurance groups

The organisation of group supervision aims to anticipate the requirements of the Solvency II regime by increased harmonisation and the consistent application of the rules in order to ensure, with the aid of a European single rule book, a high standard of effective supervision over cross-border groups. The primary aims are not only to protect policyholders and safeguard financial stability, but also to prevent regulatory arbitrage and maintain a level playing field.

In connection with the supervision of insurance groups, the Bank attends nine colleges of supervisors. It chairs three of those colleges as the home supervisor, and takes part in the others as the host supervisor. For two other insurance groups, the creation of a college of supervisors with the Bank as the home supervisor is currently under consideration. Finally, in the case of smaller groups, cross-border coordination operates mainly on a bilateral basis via coordination committees.

In the past year, the Bank has conducted specific supervision measures for groups for which it is the home supervisor. As the host supervisor, it has regularly consulted the other supervisors of groups in which an entity comes under Belgian prudential supervision.

At the meetings of a college of supervisors, the various supervisory authorities and representatives of the insurance group are asked to exchange information and comment on a number of specific subjects. The main aspects addressed are the conduct of a stress test, monitoring of the financial position, analysis of intra-group transactions, processing of the pre-application dossier, and analysis of certain specific risks, such as catastrophe risk.

TABLE 9 INSURANCE COMPANIES SUBJECT TO THE BANK'S SUPERVISION

	Home	Host	Solo
Complex groups	KBC-group	AXA-group	
	Dexia-group	Secura (Group QBE)	
	Ageas-group		
	Ethias-group		
	P&V-group		
International enterprises		29	
Other	4		53

Source: NBB.

The action plan for the colleges of supervisors in which the Bank is the home supervisor comprised, in addition to the general objectives, three specific aims: the exchange of the QIS 5 results and a follow-up discussion, definition of a timetable for processing the pre-application dossier for internal models at group level, and the conduct of a crisis simulation exercise based on the current emergency plan.

3.4 Oversight and prudential supervision of financial market infrastructures

Since the adoption of the 'twin peaks' supervision model in April 2011, the Bank has been responsible for both the oversight of the financial market infrastructures and the prudential supervision of the regulated institutions which operate those infrastructures. The Bank's oversight of the payment and settlement infrastructures forms part of its responsibilty of promoting the security and efficiency of the financial system as a whole. The prudential supervision is intended to ensure that the market infrastructures are robust at microeconomic level, thus helping to maintain the confidence of the institution's counterparties and to promote financial stability. In order to pool expertise and reinforce the synergies between the oversight function and that of prudential supervision, these two functions are performed by the same team.

Many infrastructures subject to the Bank's oversight and/or supervision have an international dimension. Some limit their operations to the euro area while others are active worldwide. In accordance with the principles of cooperation in oversight and supervision, the Bank assumes the role of lead overseer/supervisor of international infrastructures located in Belgium, such as the Society for Worldwide Interbank Financial Telecommunication (SWIFT) and Euroclear. As the corollary to that, the Bank also takes part, under the direction of the central banks or supervisory authorities of the countries concerned, in the oversight and cooperative supervision of international infrastructures based outside Belgium but providing services for Belgium.

3.4.1 Oversight

SWIFT

The Bank acts as lead overseer of SWIFT, since the company is based in Belgium. The oversight of SWIFT is conducted jointly with the G10 central banks. SWIFT is not a payment system but provides essential messaging services for payment and securities settlement infrastructures throughout the world. The Bank's oversight of SWIFT is justified by the institution's crucial importance for the security and efficiency of payment and securities settlement systems.

TABLE 10 FINANCIAL MARKET INFRASTRUCTURES SUBJECT TO THE BANK'S SUPERVISION AND OVERSIGHT

	International college of supervisors / cooperative oversight agreement		The Bank acts as the sole authority
	The Bank acts as the principal authority	The Bank participates under the direction of another principal authority	
Prudential supervision	Bank of New York Mellon SA/NV (BNYM) [1]		Belgian branch of BNYM
			Payment and electronic money institutions (±15)
Prudential supervision and oversight	Euroclear Belgium (ancienne CIK) (ESES)	LCH.Clearnet SA/NV	Euroclear Bank [2]
	Euroclear SA/NV		Atos Worldline [3]
Oversight	SWIFT	Target2 Securities (T2S) [3]	NBB-SSS
		Target2 (T2) [3]	Bancontact/Mister Cash [3]
		CLS	CEC [3]
			MasterCard Europe [3]

Source: NBB.
(1) BNYM SA/NV is the European headquarters of the BNYM group. The Bank is the principal authority in the college of European supervisors.
(2) The Bank works on an ad hoc basis with other central banks concerned.
(3) Peer review in the Eurosystem.

In 2011, SWIFT supplied the overseers with an updated version of its self-assessment report on the High Level Expectations (HLEs) forming the framework for the oversight of SWIFT's activities. The conformity with the HLEs demonstrated by SWIFT does not reflect the opinion of the overseers but is SWIFT's own assessment regarding the HLEs.

In 2011, one of the main focal points of the oversight activities was the monitoring of new projects launched by SWIFT as part of the SWIFT 2015 strategy. The overseers analysed these projects since they have an impact on the critical services of FIN and SWIFTNet. FIN is the SWIFT store-and-forward messaging service, while SWIFTNet is the internet-protocol-based platform which offers a broad range of other SWIFT products and services, in addition to FIN. The other areas included in the SWIFT oversight are cyber defence, IT audit activities, security risk management and corporate risk management.

OVERSIGHT OF CARD PAYMENT SCHEMES AND RETAIL PAYMENT SYSTEMS

In 2010, the assessment reports concerning the conformity of the domestic card payment schemes with the harmonised standards of the European System of Central Banks (ESCB) were finalised and submitted for peer review. For Belgium, the Bank assessed the conformity of the Bancontact-MisterCash system. Progress was also made in that period on the assessment of the international card payment systems. The Bank acts as lead overseer for MasterCard Europe, which has its headquarters in Belgium.

In late 2011/early 2012, the Eurosystem was to present a report on the assessment of these domestic and international systems for the sector as a whole in Europe. The main findings will be published on an aggregate basis. As is usual in any assessment exercise, the results for each entity assessed may give rise to recommendations addressed directly to the authority in charge of the governance of that entity. The latter is then expected to produce an action plan to implement those recommendations, or to show that an equivalent risk reduction will be achieved by appropriate organisational adjustments.

In regard to retail payment systems, the oversight concerned the Centre for Exchange and Clearing (CEC), which is the Belgian automated clearing centre. This system, which belongs to the banking sector and is operated by the Bank, processes retail payments in the form of transfers (domestic and SEPA – Single European Payments Area), credit and debit cards, direct debits and the exchange of cheques. Settlement takes place once a day on a multilateral net basis. In the risk classification used at European level, the CEC is regarded as important but not systemically critical. Conformity with the standards applicable to this category of system had already been assessed previously. In recent years the Bank, in its role as overseer of the CEC, has tightened up its requirements concerning the management of the financial risks, and recommended that the system should increase the frequency of settlement cycles. The aim is to limit the amounts concerned if a participant were to be unable to meet its obligations. An agreement was concluded with the CEC's owners on the establishment of multiple settlement cycles, which implies a fundamental change for this system. The introduction of these new settlement arrangements could be linked to another major project to be carried out shortly, namely the CEC's migration to an automated clearing house compatible with the SEPA standards.

OVERSIGHT OF SECURITIES SETTLEMENT SYSTEMS

The Bank exercises its responsibilities regarding the oversight of securities settlement systems (SSS) in respect of four entities offering settlement services in Belgium, namely the companies in the Euroclear group (Euroclear SA/NV – ENV, Euroclear Bank – EB and Euroclear Belgium) and NBB-SSS, the settlement system for Belgian government debt and other fixed term income marketable securities.

ENV is the Euroclear group's parent company. It owns the securities processing platforms and offers a number of common services for the group's (international) central securities depositaries – (I)CSDs –. While the oversight of these (I)CSDs is always conducted individually by each competent authority, an international cooperation agreement was drawn up for the coordination of the regulatory initiatives connected with the common services offered by ENV to group CSDs. The Bank is in charge of coordinating this multilateral cooperation process.

Since Euroclear decided to abandon its single platform project and instead to modernise the existing local platforms, the overseers of the Euroclear group wanted to make certain that the needs of each market were duly taken into consideration in drawing up the investment plan. Regarding the internal governance of the project, the IT governance and the various local and group committees which determine the project priorities were judged appropriate. In the case of the external governance, a questionnaire was sent to the local CSDs of Euroclear and to selected participants in the Market Advisory Committees, in order to examine how the latter assessed their role in the Euroclear decision-making process and to see whether Euroclear's decisions were properly communicated and explained to the market.

The Bank is also in charge of supervising Euroclear Belgium, the central securities depositary for Belgian securities, which is one of the national CSDs included in the Euroclear group. Euroclear Belgium operates on the same IT platform – ESES (Euroclear Settlement for Euronext-zone Securities) – as Euroclear France and Euroclear Nederland. The governance structure of the three ESES CSDs has also been harmonised. The overseers and supervisory authorities of these three countries concluded a cooperation agreement on subjects connected with the ESES CSDs. The authorities also adjusted the ESES arrangements concerning crisis communication, owing to the high probability that an IT incident on the ESES platform would affect the three CSDs.

Finally, the Bank is also the overseer of the international CSD of the EB group. This institution, which provides settlement and depositary services for international securities such as bonds, equities and collective investment funds, underwent an assessment in 2011 in relation to the standards of the ESCB-CESR (Committee of European Securities Regulators), the forerunner of ESMA. Specific attention focused on liquidity risk management.

In 2011, following an analysis of the implications of a long-term IT breakdown affecting both the active data centres and the two back-up centres for the (international) CSDs of the Euroclear Group, the Bank asked EB to conduct a more detailed analysis of its own specific services, notably the interdependences with other market players and infrastructures. That analysis is to supply fuller information on EB's ability to perform the critical functions, even in the extreme scenario in which all data centres are out of action for a period of five days. In particular, it will consider EB's ability to set priorities for systemic operations, the accessibility of historical data, and the interactions with counterparties (participants, central banks, depositors and correspondents).

As well as assessing Euroclear, in 2011 the Bank completed the assessment of the NBB-SSS system in the light of the ESCB-CESR recommendations for securities settlement systems. A scheme for implementing the recommendations (1) was agreed with the operator.

3.4.2 Prudential supervision of institutions operating financial market infrastructures

As stated in the introduction to this section, alongside the oversight of payment and securities settlement infrastructures the Bank also conducts the prudential supervision of institutions directly linked to those infrastructures, if they have the status of credit or payment institutions. In Belgium, this applies in particular to the Bank of New York Mellon (BNYM), the Euroclear group and the payment and electronic money institutions.

In 2009 and 2010, the BNYM group, which is active mainly in clearing, settlement and custody, implemented a strategy to strengthen its presence in Europe via its Belgian entity, BNYM SA/NV, by effecting acquisitions and establishing branches. The group continued its strategy in 2011 by integrating into its German branch a German company acquired in 2010, and by opening a new branch in France. The Bank supervised the integration of the entities acquired from the point of view of the three main risks inherent in clearing, settlement and custody activities, namely operational risk, liquidity risk and credit risk. In anticipation of the outcome of this first phase of the reorganisation of the group's presence in Europe, the Bank also undertook to hold periodic meetings with the regulators in whose jurisdiction the BNYM SA/NV branches are located, in order to prepare for the establishment of a college of supervisors as prescribed by CRD III. That college was formally set up in the closing months of 2011.

During 2011, the prudential supervision of the Euroclear group concentrated mainly on monitoring the group's profitability, against the backdrop of the abandonment of the strategic 'Single Platform' programme in 2010 and the change of management team. Special attention also focused on the proper transposition of the CRD III principles concerning remuneration policy, intended to establish a clear, strong link between the remuneration received by a group's managers and the pursuit of the group's long-term interests. In addition, a cooperation agreement on the supervision of settlement/delivery operations outsourced by Euroclear Belgium to Euroclear France was concluded between the Belgian authorities (the Bank and the FSMA) and the French (Autorité des marchés financiers and the Banque de France) on 1 July 2011, in order to enable the Belgian authorities to continue supervising Euroclear Belgium's compliance with its obligations under Belgian law.

Finally, the prudential supervision of payment institutions became fully operational in 2011, since the European Directive of 13 November 2007 on payment services in the internal market set the date of 30 April 2011 as the deadline for regularising the situation of payment service providers already active on 25 December 2007. A number of entities meeting those conditions were therefore granted approval as payment institutions following the analysis of their licence applications.

In addition, various companies wishing to launch activities in the field of payment services submitted their plans

Box 5 – Synergy for the oversight and prudential supervision of Euroclear

Although the Bank and the former CBFA had already been working together for some years in regard to the Euroclear group, now that the prudential supervision and oversight of Euroclear have both been placed with a single entity at the Bank it is possible to develop more synergies on the following aspects:

- Data collection to ensure that all prudential and oversight information is shared and to eliminate any duplication.
- Harmonisation and coordination of supervision activities so that:

  a) duplication is avoided and maximum use is made of the available expertise, e.g. by focusing certain on-site prudential checks on oversight points for attention;

  b) teams in which prudential supervision and oversight are integrated conduct certain risk analyses which allow the two approaches to be combined from an overall perspective;

  c) analyses and conclusions relating to oversight and supervision form the subject of mutual discussions and checks in order to arrive at analyses and conclusions covering both aspects.
- Contact with the institution: in order to speak with one voice regarding oversight and prudential supervision of high risk classes, such as liquidity risk, operational risk, governance or credit risk. For each requirement or formal recommendation addressed to Euroclear, there will be systematic reference to the statute concerned, namely prudential supervision or oversight.
- Transition to a common annual plan comprising an oversight section and a prudential section, thus comparing the risk analysis conducted from the micro-prudential angle with that from the point of view of systemic risk.

to the Bank to determine whether the services envisaged actually fell within the scope of the payment services directive. A number of those companies submitted formal approval applications following that preliminary analysis. Some of them were granted approval as payment institutions, and began operating during 2011.