Report 2015

Prudential regulation and supervision

National Bank of Belgium

Eurosystem

General introduction

2015 saw the continuing implementation of the measures adopted in the wake of the financial crisis to strengthen the financial sector and safeguard financial stability. This was the first full year in which the Bank had exercised its macroprudential mandate. 2015 was also the first year in which the Bank and the ECB jointly performed their role in microprudential supervision via the single supervisory mechanism (SSM). The Belgian framework for bank recovery and resolution was implemented with, among other things, the commencement of the Resolution College's duties. Further steps have been taken at both national and international level on devising a similar framework tailored to the characteristics of insurance companies and market infrastructures. Progress was also made on the creation of the third pillar of the banking union, the common deposit guarantee system, in the form of a draft Regulation on the European Deposit Insurance Scheme.

The entry into force on 1 January 2016 of a new regulatory framework for insurance companies (Solvency II) brings a major challenge, both for the sector and for the supervisory authority. During the year under review, due attention was therefore devoted to the preparation of this new framework. The Bank was also designated as the competent authority for the approval and supervision of central securities depositories (CSDs).

The Capital Markets Union launched in the spring of 2015 is another key European initiative for strengthening financial stability. It should stimulate capital market financing and reduce market fragmentation. More efficient and effective financial markets should lead to more flexible investment funding, while a diversification of funding sources contributes towards risk-sharing and hence financial stability. The proposals concerning simple, transparent and standardised securitisation are a first practical step. The promotion of the harmonious development of shadow banking is in line with those objectives.

The aforesaid reforms concerning the regulation and architecture of prudential supervision formed an integral part of the priorities in the Bank's 2015 Annual Risk Review. Those priorities are increasingly influenced by international and European developments, in this instance the SSM. The persistently low interest rate environment and the hesitant economic recovery were decisive in determining the priorities for this annual exercise. Those two factors are exerting downward pressure on interest income, with all the associated consequences for profitability. In addition, they may also tend to intensify the quest for high-yield assets, which are generally associated with a higher risk (search for yield).

Against that backdrop, the Bank paid particularly close attention to analysis of the business models and profitability drivers of banks, insurance companies and financial market infrastructures. This examination was supplemented by specific transversal analyses, concerning such aspects as interest rate, liquidity and credit risk. As regards credit risk, developments on the residential property market were closely monitored. In the financial sector, the ever-growing importance of digitalisation demands special attention to the cyber risks facing the sector. Finally, extra resources were devoted to combating money-laundering and terrorist financing.

A. Macroprudential policy

1. Introduction

2015 was the first full year in which the Bank exercised the new macroprudential mandate conferred on it by the Law of 25 April 2014 (1) (the "Banking Law"). In that connection, the Board of Directors met three times as the macroprudential authority. Since the entry into force of the SSM, the Bank has fulfilled this responsibility jointly with the ECB.

This shared competence illustrates the specific role of macroprudential policy in the maintenance of financial stability within a system featuring a common currency and closely interlinked financial markets. In enabling account to be taken of the asynchrony of the Member States' economic and financial cycles and of the more structural characteristics which still distinguish the national financial systems, macroprudential policy allows the authorities of the various euro area countries some scope to guard against the risks that these specific national characteristics and developments could present for financial stability within their own economy and, potentially, by extension, for the euro area as a whole. However, the ECB limits this significant degree of national autonomy in the conduct of macroprudential policy in view of the potential interference with monetary policy or the possible risks of distortion in the exercise of microprudential supervision.

Many EU countries, including Belgium, have recently applied macroprudential measures to their banking system, enabling the European arrangements to be tested. Those arrangements list the categories of instruments available to the supervisory authorities and also lay down detailed notification and authorisation procedures.

Macroprudential policy is generally aimed at two main objectives. The first is to limit structural risks, notably the risk of contagion that could result from an excessive concentration of financial operations in a small number of large systemic institutions. The macroprudential instruments set up for that purpose are examined in section 2.

The second objective is to attenuate the risks arising from financial cycles, which lead to rapid expansion of lending with the consequence of excessive debt in the economy as a whole or in certain sectors, and overvaluation of the prices of some financial or real assets. The subsequent correction can lead to a sharp fall in prices, severe debt repayment problems, and a general reduction in demand. This use of macroprudential policy for countercyclical purposes is discussed in section 3.

Finally, section 4 considers the possible extension of macroprudential policy beyond the banking sphere to which it has so far been largely confined.

(1) Law of 25 April 2014 on the legal status and supervision of credit institutions.

2. Avoiding the concentration of banking activities

Systemically important banks are institutions whose failure could have a significant impact on the financial system or on the real economy. There are two reasons justifying the imposition of additional capital requirements in their case : (1) to limit the risk of the institution's default, since such a failure would entail high economic and social costs ; (2) to require the institution to maintain a capital reserve ("buffer"), reflecting the negative external effects that its default would cause.

At world level, the Basel Committee on Banking Supervision and the Financial Stability Board (FSB) have drawn up a list of global systemically important banks (G-SIBs) and divided them into sub-categories according to the institutions' global systemic importance. From 2016 onwards, these G-SIBs will have to have a common equity Tier 1 (CET 1) buffer of between 1 % and 3.5 % of the total risk exposure, depending on the G-SIB class to which the credit institution belongs ; the greater the bank's systemic importance, the larger the buffer must be. BNP Paribas Fortis and ING Belgium are Belgian subsidiaries of global systemically important banks, but no Belgian group has been designated as a G-SIB.

Banks which are not of global systemic importance may nevertheless be systemic at regional or national level. Domestic systemically important banks (D-SIBs) are institutions whose failure could have a significant impact on the national financial system and on the real domestic economy. With effect from 1 January 2016, the Bank is required to list the D-SIBs established in Belgian territory (referred to as other systemically important institutions or O-SIIs in the CRD IV) and publish it each year. The Bank may also impose supplementary capital requirements on D-SIBs.

During the year under review, the Bank adapted its methodology for identifying D-SIBs in line with the European Banking Authority (EBA) guidelines on the designation of O-SIIs [1], and identified the Belgian D-SIBs in accordance with the new methodology. The Bank also decided to impose a capital surcharge on the D-SIBs.

2.1 Identification and publication of Belgian D-SIBs

The EBA methodology for identifying O-SIIs comprises two steps. In the first step, certain institutions are automatically designated as O-SIIs on the basis of a quantitative score for systemic risk ; in the second step, other institutions may be added at the discretion of the supervisory authority.

First, scores are calculated for banks on the basis of indicators relating to their size, the complexity of their activities, their interconnectedness and their substitutability. The EBA guidelines are based on a list of mandatory indicators combined with a weighting factor in calculating the total score for an institution's systemic relevance. In that respect, they correspond very closely to the criteria used in the methodology for identifying G-SIBs. Any bank which has a total systemic importance score above a set threshold is automatically designated as a D-SIB. Next, the authorities have the option, at their discretion, of using other indicators or applying other weighting factors to the EBA's mandatory indicators in order to classify

(1) EBA guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD IV) in relation to the assessment of other systemically important institutions (O-SIIs). See also the National Bank of Belgium Regulation of 10 November 2015 on the method of designating domestic systemically important institutions and determining the amount of the Tier 1 capital buffer.

other institutions as D-SIBs in addition to those designated automatically.

On the basis of this methodology, eight Belgian banks were designated as D-SIBs: BNP Paribas Fortis, KBC Group, ING Belgium, Belfius Bank, AXA Bank Europe, Euroclear, The Bank of New York Mellon (BNYM) and Argenta. The first seven were designated automatically as D-SIBs on the basis of their score according to the EBA methodology, while Argenta[1] was added in the second stage. The supplementary indicators taken into account in the second step of the methodology were the banks' share in deposits in Belgium, in loans in Belgium, and in the liabilities and assets in the financial system in relation to Belgian counterparties. Particular attention focused on deposits. These supplementary indicators were chosen because indicators of national relevance are regarded as more appropriate for designating domestic systemically important banks than indicators of European or global relevance. The list of institutions designated as Belgian D-SIBs was published on the Bank's website and will be revised annually, in accordance with the Banking Law[2] and the EBA guidelines.

2.2 Additional capital requirements for Belgian D-SIBs

Although the European legislation does not lay down specific guidelines for determining the level of the capital surcharge for D-SIBs, the Basel framework specifies two principles for that purpose. First, the level of the additional capital requirement must be in proportion to the institution's systemic importance. In practice, the institutions are divided into categories (or 'buckets') according to their systemic importance, and each category corresponds to a particular capital surcharge. Second, wherever possible and without prejudice to the need for a qualitative assessment, the authorities are required to use quantitative methods to determine the level of the capital surcharge. In that context, after calculating the total systemic importance score in accordance with the EBA guidelines, the Bank conducted a number of quantitative analyses to determine the amount of the additional capital buffers stipulated for Belgian D-SIB.

The Bank decided to apply capital surcharges[3] to each of the eight Belgian D-SIBs, dividing them into two groups according to their systemic importance. Institutions in the first group, namely AXA Bank Europe, Argenta, Euroclear and BNYM, are of lower systemic importance and are required to maintain an additional Tier 1 capital buffer (CET 1) of 0.75 % of the risk-weighted assets. Institutions in the second group, namely BNP Paribas Fortis, KBC Group, ING Belgium and Belfius Bank, which are of greater systemic importance, are subject to a CET 1 buffer

(1) Since Dexia is subject to specific requirements of an EU-approved restructuring plan, it was not included in calculating the systemic relevance score.
(2) Article 14 of Annex IV of the Banking Law. Transposition of Article 131 of Directive 2013/36/EU (CRD IV).
(3) National Bank of Belgium Regulation of 10 November 2015 on the method of identifying domestic systemic institutions and determining the amount of the Tier 1 capital buffer (CET 1).

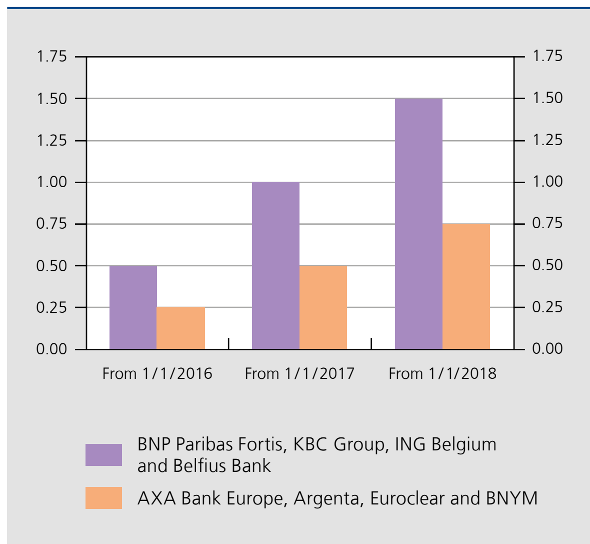
TABLEAU 1 MANDATORY INDICATORS ACCORDING TO THE EBA METHODOLOGY
(in %)

Criterion	Indicators	Weighting
Size	Total assets	25,00
Importance (including substitutability/financial system infrastructure)	Value of domestic payment transactions	8,33
	Deposits from the private sector in the EU	8,33
	Loans to the private sector in the EU	8,33
Complexity/cross-border activity	Value of OTC derivatives (notional)	8,33
	Cross-border liabilities	8,33
	Cross-border claims	8,33
Interconnectedness	Liabilities towards financial institutions	8,33
	Claims on financial institutions	8,33
	Outstanding debt instruments	8,33

Source: EBA guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD IV) in relation to the assessment of O-SIIs.

CHART 1 LEVEL OF ADDITIONAL CAPITAL REQUIREMENTS FOR BELGIAN D-SIBS

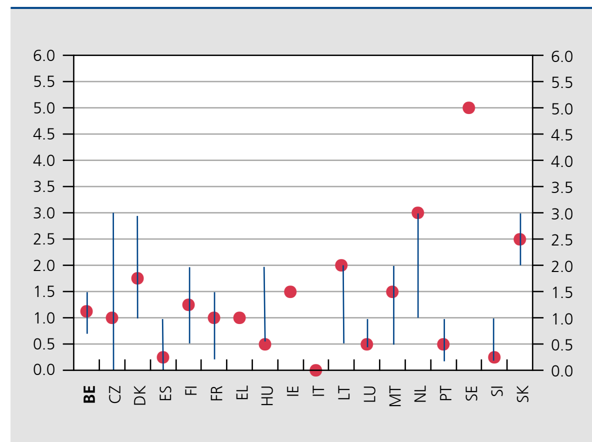
(in % of the risk-weighted assets)



Source: NBB.

CHART 2 INTERNATIONAL COMPARISON OF CAPITAL SURCHARGES IMPOSED ON D-SIBS

(in % of the risk-weighted assets (1))



Sources: EBA, ESRB, NBB.

(1) The red dots indicate the median value of the capital surcharges applied to D-SIBs in each country. The vertical lines represent the ranges within which those surcharges vary. They correspond to the additional capital requirements (in %) imposed on D-SIBs. These surcharges may be imposed under Article 131 of CRD IV (O-SII buffer), Article 133 of CRD IV (systemic risk buffer) and/or pillar 2 requirements.

of 1.5 %. These capital surcharges will be phased in over a three-year period from 1 January 2016.

A comparison of the levels of capital surcharges already announced in other European countries shows that most of them range between 1 % and 3 %, though there are exceptions, lower levels being imposed in Spain, Hungary, Italy, Luxembourg, Portugal and Slovenia, and higher ones in Sweden. This comparison also shows that the capital surcharges imposed on Belgian D-SIBs correspond to the European average. More specifically, the Belgian requirements are generally higher than those in the countries mentioned above as imposing relatively low surcharges, but lower than those in Denmark, Lithuania, the Netherlands, Sweden and Slovakia. The requirements specified by the Belgian authorities are more comparable to those in Finland, France, Greece, Ireland and Malta. These differences between European countries may be due to the degree of the banks' systemic importance or to divergent policy choices.

3. Limiting the cyclical effects of banking activities

3.1 Countercyclical capital buffer

During the year under review, the Bank defined the scope of the countercyclical Tier 1 capital buffer (countercyclical capital buffer – CCB) in accordance with the European and Belgian regulations. The CCB was introduced under the Basel III framework and aims to promote sustainable lending during the cycle by augmenting the credit institutions' resilience. Thus, capital buffers are imposed if the cyclical systemic risk increases (e.g. in the case of excessive credit expansion) and the requirements can then be eased when the cycle turns around and the risks begin to diminish. If risks become apparent, as in a financial stress situation, the supervisory authority may decide to release the buffer in order to give the banks some scope for absorbing losses and maintaining their supply of credit.

By law, the Bank must set the percentage of the countercyclical capital buffer on the basis of one or more reference indicators reflecting the credit cycle and the risks associated with excessive credit expansion in Belgium, taking account of the specific characteristics of the national economy. That primarily concerns the ratio between the volume of lending in Belgium in relation to GDP and that ratio's deviation from its long-term trend, known as the credit/GDP gap. As described in its Communication on strategic choices [1] and in chapter 3 of the section of this Report on "Economic and financial developments", the Bank bases its calculation of the credit/GDP gap on the narrow concept of credit which comprises lending by resident banks to the resident non-financial private sector, adjusted for securitisation. However, the buffer percentage is not automatically deducted from the value of the credit/GDP gap. In accordance with the ESRB's recommendations, a wide range of indicators regarded as relevant for signalling an increase in cyclical systemic risks are also monitored. They reflect not only developments in lending such as credit expansion in various sectors and the credit/GDP gap on the basis of broader credit concepts, but also, for example, signs of property price overvaluation and structural vulnerabilities, such as private sector debt levels and the leverage effect in the banking sector. The decision on the countercyclical buffer percentage forms part of the Bank's broader macroprudential risk analysis framework, described in the 2014 Report [2].

With effect from 1 January 2016, the Bank has to determine each quarter the countercyclical capital buffer percentage applicable to credit exposures on counterparties established in Belgium. The buffer percentage must in principle be set between zero and 2.5 % of the risk-weighted assets, but it may be set at a higher level if that is justified by the underlying risks. On the basis of the information mentioned above, from which a selection of key indicators is published in detail on the Bank's website at the time of each decision, the Bank sets the appropriate countercyclical buffer percentage and informs the ECB. The ECB has the power to increase that percentage but may not reduce it. According to the information available in the last quarter of the year under review, neither credit developments nor the other indicators used implied any increase in systemic risk. For the first quarter of 2016, the CCB was set at 0 % [3] for credit risk exposures on counterparties established in Belgium. That buffer percentage applies from 1 January 2016 and will be reviewed after three months.

(1) "Strategic choices for determining the countercyclical buffer in Belgium" (www.nbb.be).
(2) See box 3 in the section on "Prudential regulation and supervision" in the 2014 Report.
(3) National Bank of Belgium regulation of 24 November 2015 on the determination of the countercyclical Tier 1 capital buffer percentage (CET 1).

The Belgian banks also have to apply the CCB percentage set by foreign supervisory authorities for their credit risk exposures in the countries concerned. However, in view of the current financial cycle position, the Member States set the level of their CCB at 0 % for the first quarter of 2016. Only Norway and Sweden set a positive buffer percentage of 1 %, applicable from the third quarter of the year under review. The CCBs of third countries must also be applied in the case of local risk exposures. In that connection, the European Systemic Risk Board (ESRB) centrally monitors any third country risks relevant to Belgium [1].

3.2 Residential property

On the subject of residential property, the Bank has conducted an in-depth analysis of the Belgian mortgage market in the past few years and has charted the risk profile and quality of credit institutions' mortgage loan portfolios. That examination was based partly on data collected from sixteen credit institutions via a reporting scheme developed specifically for data on Belgian mortgage loans held and granted by these institutions. The analyses conducted by the Bank and by international institutions such as the ECB, the ESRB, the OECD and the IMF drew attention to the potential risks associated with the Belgian housing and mortgage market. Although the household solvency indicators do not yet point to any deterioration in the mortgage loan default rate in recent years, there are nevertheless several factors which could lead to increased loan losses in the future. In the face of less favourable developments on the Belgian residential market, the riskier outstanding mortgage loan segments could be a source of higher-than-expected loan losses for the banks. As described in the 2013 Report, the Bank considered it justified to adopt a range of prudential measures in order to enhance the banks' resilience and reduce the concentration risk. The most important measure adopted in the final quarter of 2013 was a macroprudential measure stipulating a flat-rate 5 percentage point increase in the risk weightings for banks using an internal ratings-based approach (IRB model) to calculate their minimum capital requirements for mortgage loans in Belgium. However, considering the cyclicality of this measure, the Bank kept a close eye on market developments during the year under review so that it could continuously assess the appropriate level of this percentage supplement. It concluded that the 5 percentage point supplement (equivalent to around € 600 million of additional capital) still provided an adequate but necessary capital buffer in view of the risks identified. In the final quarter of the year under review, it therefore initiated the necessary procedure for extending the measure in 2016. That extension requires the agreement of the competent European institutions in accordance with Article 458 of the Capital Requirements Regulation (CRR) [2].

(1) Brazil, Hong Kong, China, Turkey, Russia and the United States.
(2) Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

4. Extension to other financial sectors

4.1 The shadow banking system

Financial and technological innovations have facilitated and accelerated the emergence of alternatives to bank intermediation. Moreover, the search for yield and the regulatory requirements have prompted the transfer of the activities of traditional financial institutions to structures subject to less stringent rules or weaker constraints. It is important to monitor the development of these new structures, often referred to as shadow banking (for the definitions, see box 12 "Shadow banking in Belgium"). On the one hand, the growth of the non-bank financial sectors, including shadow banking, has led to diversification of funding sources. The resulting more efficient allocation of capital contributes to the deepening of the financial sector, which is one of the aims of the European Capital Markets Union project. On the other hand, there are also risks in the development of shadow banking: it increases the complexity of the intermediation circuit, and the less stringent regulation plus the absence of a legal safety net heightens the vulnerability of not only the shadow banks but also the financial sector as a whole, owing to the interconnections with other financial institutions.

In order to prevent the risks from jeopardising the stability of the entire financial system and to devise appropriate regulations, the FSB recommends introducing shadow bank monitoring in order to identify and regularly assess the risks. In Belgium, the results of this monitoring exercise discussed in box 12 "Shadow banking in Belgium" indicate that the investment fund sector has grown considerably since 2011, owing to the search for yield in a low interest rate environment, and that trend continued during the year under review.

Box 12 – Shadow banking in Belgium

The FSB defines shadow banking as a "credit intermediation involving entities and activities outside the regulated banking system", and renders that definition applicable in practice by including in the national financial accounts – which are drawn up on the basis of a residence criterion – money market investment funds, non-money market investment funds, other financial intermediaries, financial auxiliaries and non-institutional lenders in a multinational group (captive financial institutions and money lenders). That is the broad definition of the shadow banking system [1].

The Bank applies this basis of international comparison while adapting it in the light of the systemic risks associated with the activities of those sectors in Belgium. For that purpose, the Bank has adopted a criterion which is both narrower in some respects and wider in others to take account of the specific characteristics of the Belgian

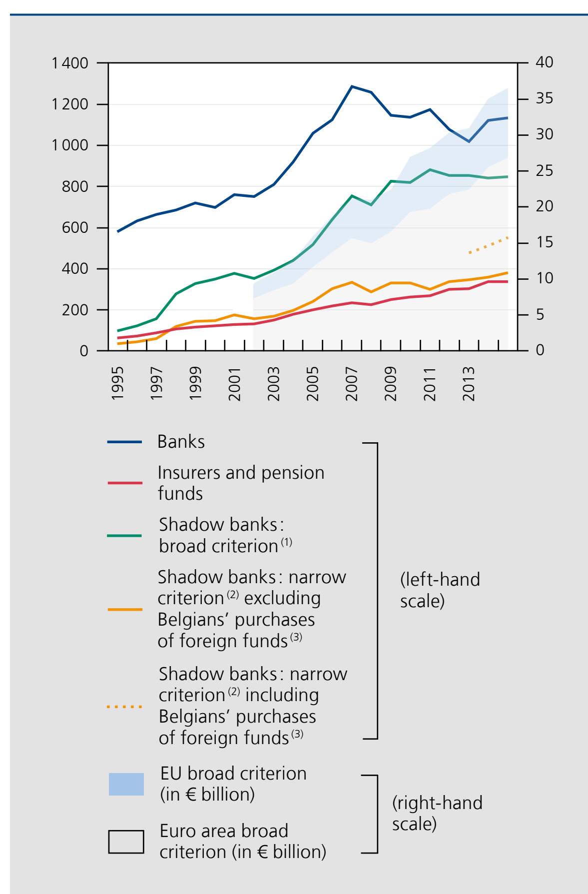
(1) There are financial interconnections between the various entities of the financial sector as a whole and in the shadow banking sector in particular. Those interconnections lead to double counting if their assets are added together. That applies, for example, to insurance companies that invest in investment funds, or investment funds that invest in other funds.

financial sector. The criterion is made narrower by excluding financial institutions and non-institutional lenders operating within a multinational group, on account of their specific nature. Although these institutions have expanded significantly, thanks first to the attractiveness of the coordination centres and then the notional interest deduction system (their assets totalled € 460 billion in the second quarter of the year under review, or 55 % of the broad indicator), they nevertheless effect mainly intra-group transactions and engage in hardly any investment or borrowing with external institutions (such as banks). They therefore do not have any credit intermediation function.

Conversely, the Belgian criterion was widened concerning the coverage of investment funds. These form a major category in shadow banking which has expanded greatly in recent times. To obtain a more comprehensive overall view of this sector, the assets of Belgian funds were extended to include acquisitions by Belgian residents of units in investment funds based in other countries but marketed in Belgium, often managed by resident banks. However, no data are available before the year 2013.

MAIN FINANCIAL SECTORS AND SHADOW BANKING

(assets in € billion, unless otherwise stated)



Source: NBB.

(1) The broad criterion for shadow banks includes money market funds, non-money market investment funds, other financial intermediaries, financial auxiliaries and intra-group financial institutions and non-institutional lenders.

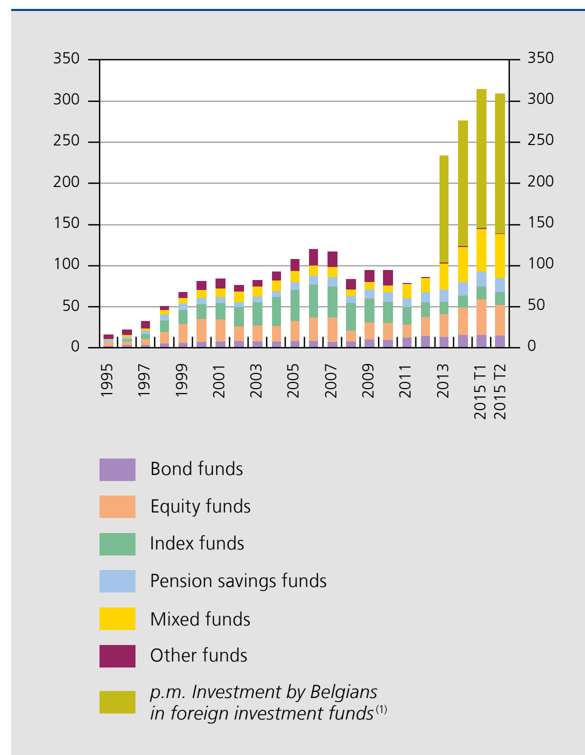
(2) The narrow criterion for shadow banks corresponds to the broad criterion except for financial institutions and non-institutional lenders operating within a multinational group.

(3) Estimate based on the financial accounts for investment by Belgian residents in foreign investment funds.

A review of the growth of the various financial market segments reveals that the expansion of the assets of the largest sector – the banking sector – stagnated in 2008 when a major restructuring of the banking industry was undertaken, following the economic and financial crisis. Since 2013, the sector has resumed a slow upward trend. During the crisis, shadow banking continued to gain ground, and – defined according to the broad criterion – it continued to grow until 2012, when it stabilised at roughly € 850 billion or 36 % of the global financial sector. That stabilisation was not seen in either the EU or the euro area. On the contrary, in 2014 and at the beginning of the year under review, the sector continued to grow strongly. It also recorded steady growth according to the narrow Belgian criterion, and, in the second quarter of the year under review, represented 16 % of the financial sector as a whole, or € 381 billion; that rises to € 551 billion if Belgians' investments in foreign funds are included.

The recent growth of the shadow banks is due largely to the success of investment funds, attributable to investors' search for yield in a low interest rate environment. In regard to Belgian investment funds, it is mainly mixed funds offering investment in equities and bonds that have enjoyed increasing success since 2011. Apart from net purchases of fund units which remained positive during the year under review, price effects also contributed to the rise in the outstanding amounts. As a result of these two factors combined, Belgian investment funds recorded an outstanding total of € 144 billion at the end of the second quarter in the year under review. Belgian residents also invested € 169 billion in foreign funds.

ASSETS OF BELGIAN INVESTMENT FUNDS AND ACQUISITIONS OF FOREIGN FUNDS BY BELGIANS
(assets in € billion)



Source: NBB.
(1) The broad criterion for shadow banks includes money market funds, non-money market investment funds, other financial intermediaries, financial auxiliaries and intra-group financial institutions and non-institutional lenders.
(2) The narrow criterion for shadow banks corresponds to the broad criterion except for financial institutions and non-institutional lenders operating within a multinational group.
(3) Estimate based on the financial accounts for investment by Belgian residents in foreign investment funds.

Apart from better risk monitoring, further work is in progress, notably at the instigation of the FSB, the Basel Committee on Banking Supervision and the ESRB, to revise the regulations on shadow banking. There seems to be a broad consensus that it will not be possible to impose the same measures as those applicable to banks, but that account will need to be taken of the specific characteristics of the entities and their activities. In the case of investment funds, a fast-growing sector as described in box 1, the risks are twofold. In periods of financial stress and low market liquidity, open-end funds which investors can exit at any time may be obliged to sell off their assets cheaply or even suspend redemptions in the event of a liquidity shortage. Investment funds must of course respect the consumer protection stipulated by law, but if the risks materialise simultaneously and in acute form in periods of financial stress, the impact on the real economy will be unavoidable, with potential indirect repercussions on the banking sector. From the banks' point of view, there is also a risk of contagion for the rest of the financial sector owing to the interconnections between investment funds and the traditional banking sector, if a bank linked to a fund manager decides to intervene for reputational reasons, even if it is not under any contractual obligation to do so ("step-in risk"). That risk is particularly worrying since it is heavily concentrated on a few Belgian banks. Scrupulous monitoring is therefore advisable.

That monitoring and those activities form part of the broader international approach from a more macroprudential angle. In that context, the ESRB is examining the risk associated with leverage effects and the liquidity risk in investment funds. More specifically, it is examining whether the current restrictions on individual funds could be better harmonised between Member States to permit consistent monitoring. On the basis of that monitoring, macroprudential measures such as stress tests, capital buffers or redemption restrictions can be developed for a sub-group of institutions which are particularly susceptible to these risks or which, owing to their size, represent a threat to financial stability.

4.2 Insurance companies

Through the essential functions that they perform in supporting economic activity and their significant role as investors on the financial markets, insurance companies may also be a source of risk to the stability of the financial system as a whole. However, insurers were less directly affected by the 2008 financial crisis, while the nature of their activities means that risks in that sector develop more slowly and over a longer time scale than in the case of the banks.

Nonetheless, the persistently low interest rates are exerting ever-increasing pressure on the profitability of that sector. While mixed insurance groups can to some extent offset the impact of these adverse financial conditions on their life insurance business with the good results achieved in the non-life segment via their efforts to improve cost management, pure life insurance companies are particularly vulnerable, especially as many of them still hold contracts in their portfolio offering guaranteed yields well above the returns that can currently be obtained on the financial markets.

This severe constraint obliges insurance companies to take long-term measures, some being aimed at improved matching of the assets and liabilities while others restrict the distribution of profits to policy-holders and shareholders when that proves necessary to preserve long-term solvency. Several years ago, in order to back up these measures, the Bank required insurers facing such a situation to form an 'additional' technical provision. Income from the assets covering that provision must be added to the income generated by the assets representing the life insurance provision, in order to guarantee the interest rate level promised in the contract.

Up to 2012, insurance companies which could demonstrate that the financial flows generated by their covering assets were sufficient to meet the liabilities arising from their insurance contracts could apply for exemption from creating this additional provision. That option has since been abolished as the current economic situation makes it likely that interest rates will remain at a low level for quite some time.

In accordance with the current insurance supervision law, the Bank, as the supervisory authority for insurance companies, is responsible for setting the maximum reference interest rate on long-term life insurance contracts (more than eight years) and revising it as circumstances change. In that connection, the Bank proposed cutting this maximum reference interest rate from 3.75 % to 1.5 % owing to the current market developments. At the beginning of January 2016, the Minister of the Economy used his power of evocation to set the maximum reference interest rate at 2 %, thus bringing it into line with the regulations on supplementary pensions.

Looking ahead, the new Solvency II Law provides for a mechanism whereby the maximum reference interest rate is fixed once a year, and for the first time on 1 January 2017. Under the new regime, the Minister of the Economy retains the option of approving, amending or rejecting the new maximum interest rate. The mechanism for calculating the maximum reference interest rate

proposed under the new legislation should more accurately reflect the current market conditions and prevent distortions of competition that could be contrary to the consumer's interests. The Bank also welcomes the agreement between the social partners on the revision of the system of guaranteed minimum interest rates for group insurance and pension contracts, as laid down by the Law of 28 April 2003 on supplementary pensions. That agreement was enshrined in the Law of 18 December 2015 and means that, from 1 January 2016, the minimum guaranteed interest rates will likewise reflect market conditions more closely.

B. Recovery and resolution

1. Introduction

In 2015, the work on common risk prevention and risk-sharing mechanisms in the financial sector continued. The Bank made progress in a number of areas concerning the framework for the recovery plans of credit institutions. For instance, it published Communications on the content of the full recovery plans, and on the nature of simplified recovery plans and the conditions for applying them. Apart from the minimum list of indicators that the recovery plans must contain, the Banking Law stipulates that credit institutions must include in their monitoring system indicators relating to encumbered assets. Thresholds in that respect were set during the year under review. Section 2 of this chapter discusses these points.

As stated in the 2014 Report, the resolution arrangements for credit institutions and certain investment firms were considerably improved in 2014. First, the legal framework was totally revamped in order to introduce new, harmonised resolution instruments in the European Union; that increased the scope for intervention by the authorities. Next, in connection with the implementation of the banking union, the introduction of the single resolution mechanism – which is now the second pillar of that union – made fundamental changes to the institutional architecture. In many Member States including Belgium, and within the banking union, the year 2015 was dominated by the operationalisation of the legal and institutional changes introduced in 2014, which are described in section 3 of this chapter. Practical manifestations of this included the launch of the work of the Resolution College at the Bank and participation in a number of pilot projects for the preparation of transitional resolution plans. Progress was also achieved in setting up the third pillar of banking union, namely the common deposit guarantee system.

At European level, the work on the insurance sector's recovery and resolution plans, discussed in section 4, is now in the development phase. Where Belgium is concerned, the Bank can impose a recovery plan on certain undertakings and, as the prudential supervisory authority of a large insurance company forming part of a global systemically important insurer (G-SII), it has taken part in the work of a Crisis Management Group.

The Communication published by the Bank, setting out the requirements for the recovery plans of financial market infrastructures, is discussed in detail in section 5. These plans are based on the banks' recovery plans, adapted in line with the sector's specific characteristics.

2. Banks

2.1 Recovery plans

A recovery plan is a management strategy aimed at preventing the failure of a credit institution in a serious stress situation. It requires identification of scenarios which are sufficiently serious to threaten the institution's survival, taking account of its business model, risks and vulnerabilities. The scenario must be more extreme than those used for other regulatory exercises, such as stress tests for the supervisory authorities. The purpose of the recovery plan is not to predict the factors that could trigger a crisis but rather to identify the available options for responding to a crisis and to assess whether those options are sufficiently robust. The recovery plan must exclude from consideration any exceptional form of state or central bank support.

In 2015, the Bank published three Communications in connection with the preparation of the recovery plans. They are discussed in the sub-sections below.

2.1.1 Contents of the full recovery plans

In its Communication dated 8 April 2015[1], the Bank described the content of full recovery plans. This Communication is meant as a user-friendly instrument which credit institutions and parent companies can use to draw up recovery plans; it sets out in a single document the requirements of the Bank Recovery and Resolution Directive (BRRD[2]), the EBA's regulatory technical standards on the content of recovery plans[3], and the EBA's Guidelines on the range of scenarios to be used in those plans[4]. This Communication will be updated to incorporate the latest EBA Guidelines on the minimum list of qualitative and quantitative indicators that recovery plans must include[5]. Since the SSM is responsible for determining the content of the recovery plans of banks considered significant, the Bank's Communication only applies directly to banks considered less significant. However, the guidelines may also be useful for the preparation of the recovery plans of significant banks because the Bank's Communication collates all the requirements in the EBA documents, whereas the SSM does not provide specific guidelines on the content of the recovery plans.

A full recovery plan must contain five components. The first sets out the main conclusions of the analysis included in the recovery plan and summarises the institution's assessment of its recovery capacity. The second part concerning governance and monitoring describes the process whereby the recovery plan was drawn up and approved. It also includes another crucial element, namely a description of the process for triggering activation of the recovery options. The framework for recovery plan activation must include a set of indicators so that stress can be detected at a sufficiently early stage for institutions to take steps to rectify their situation. Institutions are expected to describe the early warning system in the recovery plan monitoring framework together with the threshold values set for the indicators and the points at which the escalation process will be triggered. The third section comprises the strategic analysis, which can be regarded as the central feature of the recovery plan. It includes the following components: a description of the core business and critical functions of

(1) Communication NBB_2015_17 of 8 April 2015 "Recovery plans – Guidelines for credit institutions".

(2) Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council.

(3) EBA/RTS/2014/11 of 18 July 2014 on the content of recovery plans under Article 5(10) of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms.

(4) EBA/GL/2014/06 of 18 July 2014 on the range of scenarios to be used in recovery plans.

(5) EBA/GL/2015/02 of 6 May 2015 on the minimum list of qualitative and quantitative recovery plan indicators.

the institution; quantitative details of the stress scenarios which would present a serious shock for the institution; and quantitative and qualitative analyses of potential recovery options which the institution could activate in order to recover from a shock. The fourth section, the communication plan, has to describe how the institution would notify interested parties within the institution and outside it of the activation of the recovery plan. Finally, the last section sets out the preparatory measures taken by the institution to facilitate the implementation of the recovery options if necessary, and to improve their effectiveness.

To provide further assistance for the banks in drawing up their recovery plans, the Bank's Communication gives more details on the information mentioned in the EBA documents, particularly on certain aspects specific to the various sections of the plan. This Communication likewise contains templates to be used by the banks for supplying certain information that must be included in the plan. These templates help to ensure that the banks provide all the information required for recovery plans, and also facilitate assessment of the plans by the competent authorities.

Before the adoption of the Banking Law in 2014, the Bank was already working with a number of Belgian banks on the development of their recovery plans. The Banking Law stipulated that all banks which had not yet submitted a recovery plan to the Bank must do so within 18 months following publication of the Law, i.e. by 7 August 2015 at the latest. The banks subject to the full-scale recovery plan requirements have now submitted their plans. The Bank is currently assessing those plans, either in its capacity as the direct supervisory authority or in collaboration with the SSM in the case of banks subject to direct ECB supervision.

2.1.2 Simplified recovery plans

The requirements for simplified recovery plans comprise two components: (1) identification of the banks eligible for simplified recovery plan obligations, and (2) specification of the nature of those simplified obligations. Regarding the first component, Article 113 of the Banking Law stipulates that the authorities may decide to apply the simplified recovery plan obligations to institutions which "are found to be non-systemic and whose failure and subsequent winding-up under normal insolvency proceedings would not be likely to have a significant negative effect on financial markets, on other institutions, on funding conditions or on the wider economy". The Belgian D-SIBs can never be eligible for simplified obligations. On this subject, the BRRD lists the criteria to be applied in that assessment and mandates the EBA to draw up Guidelines specifying those criteria in detail.

In September 2014, the EBA published draft Guidelines for determining the banks eligible for simplified obligations; the final Guidelines [1] were published in July 2015. These guidelines contain a list of mandatory indicators that the authorities must use to determine whether a bank is eligible for the simplified obligations. Those indicators are divided into the following categories: size, interconnectedness, scope and complexity of the activities, risk profile, legal status, nature of business, shareholding structure and legal form. The EBA also sets out a number of optional indicators which the competent authorities may use. The Bank applied the EBA methodology in identifying the banks eligible for simplified obligations and duly informed the banks in question.

As regards the nature of the simplified obligations and the terms for applying them, the Banking Law (Article 113, § 2) specifies that the mandatory content of the recovery plan can be reduced and the annual updating obligation may be relaxed, while the deadline for first submission of the recovery plan may be extended. Although the BRRD specifies criteria for identifying the banks eligible for simplified obligations, it contains no criteria on the content of simplified recovery plans. The competent authorities are free to take decisions on the content of simplified plans, or classify banks into categories and apply similar requirements to all banks in the same category.

In June 2015, the Bank published a Communication with guidelines on the content of simplified recovery plans . These simplified plans must contain the same basic components as full-scale plans, but with significantly less detailed data and a less detailed quantitative analysis. More specifically, banks producing a simplified plan are subject to fewer obligations regarding the detailed description and quantification of recovery scenarios and in regard to the quantitative analysis of the impact of any recovery options. The Bank's Communication on simplified recovery plans enables the eligible banks to draw up a recovery plan tailored to their size, business model and complexity. The guidelines also postponed to 31 December 2015 the deadline for the banks' submission of their first recovery plans to the competent authorities.

2.1.3 Asset encumbrance indicators

As mentioned above, the description of the recovery plan activation process is an essential component of the plan and

(1) EBA/GL/2015/16 of 7 July 2015 on the application of simplified obligations.

contains a set of quantitative indicators used to detect stress at an early stage. While the EBA Guidelines on indicators for recovery plans contain the minimum list of indicators which must be included in every recovery plan, the Banking Law also stipulates that the banks must include indicators of asset encumbrance in their recovery plan monitoring frameworks. In the event of bankruptcy, creditors have an individual priority claim on these specific encumbered assets, which implies that the assets are no longer available to cover the depositors' preferential right. The reason for the requirement in the Banking Law is that an increase in the encumbered assets often accompanies the start of stress on financial institutions, as creditors of struggling institutions insist on more secured loans rather than unsecured loans. Indicators of encumbered assets can help to ensure that banks have sufficient unencumbered assets on their balance sheet to cover their deposit and other unsecured liabilities in the event of the bank's resolution.

The inclusion of asset encumbrance indicators in the banks' recovery plans is specific to Belgium and is not a BRRD requirement. The Banking Law stipulates that banks must take account of two indicators of asset encumbrance to ensure that sufficient unencumbered assets are available at all times to cover the deposits eligible for the deposit guarantee, for which the Banking Law specifies preferential treatment. The Regulation on Asset Encumbrance[1], which accompanies the Banking Law, defines these two asset encumbrance indicators and specifies for each indicator the range of values within which the thresholds applicable to specific banks must lie. The Bank then has to determine the bank-specific threshold values so that the values are within the range stipulated in the Regulation.

Each indicator is calculated individually as a ratio of unencumbered assets over deposits eligible for the deposit guarantee. The two indicators differ in their definition of unencumbered assets. The narrow indicator uses a more conservative criterion than the broad indicator for measuring unencumbered assets. More specifically, the narrow indicator estimates the assets which will probably be unencumbered if the bank goes into resolution. That indicator implicitly takes account of the fact that some of the assets which are currently unencumbered could become encumbered if the bank were to encounter stress and before a resolution procedure is actually launched. In contrast, the broad indicator focuses only on assets which are currently unencumbered, and disregards certain assets which would be expected to become encumbered in the normal course of business, and not as a result of stress.

The Banking Law and the accompanying Regulation set two specific thresholds for each indicator: an "early warning (or 'flashing-light') threshold" and a "recovery plan threshold". The flashing light threshold serves as a warning signal at an early stage of stress, enabling the institution to analyse the underlying cause of the declining value of the indicator and to keep a close eye on the situation. If the "recovery plan threshold" is breached, the institution has to activate the escalation process for its recovery plan, which means that the recovery or crisis committee must meet to determine whether the institution is in, or on the verge of, a recovery phase, and whether it is necessary to implement any recovery plan options. Although the credit institution has to notify the supervisory authority if either the early warning threshold or the recovery threshold for either of the indicators is exceeded, it is important to point out that if one of the encumbered asset indicator thresholds is exceeded, that does not automatically lead to activation of the recovery options.

The range of threshold values for the asset encumbrance indicators within which all bank-specific indicators must lie is specified as follows in the Regulation: from 80 % to 100 % for the narrow indicator and from 100 % to 135 % for the broad indicator[2]. In April 2015, the Bank published a Communication stating the bank-specific thresholds for these asset encumbrance indicators[3]. In order to determine the bank-specific thresholds, the Bank decided – at least for the current period – to define a small number of categories of banks on the basis of the proportion of their funding obtained from deposits eligible for the guarantee system, and to set indicator thresholds for each of those categories. This implies that all banks in the same category must respect the same indicator threshold values[4].

2.2 Resolution

2.2.1 Institutional framework

Regulation (EU) No. 806/2014[5], known as the SRM Regulation, which establishes the single resolution mechanism, was implemented in 2015. The SRM comprises the

(1) National Bank of Belgium Regulation of 1 April 2014 concerning encumbered assets in connection with recovery plans.
(2) It should be noted that, since the narrow indictor is a "forward" indicator, it is based on a criterion for encumbered assets that exceeds the actual value of the assets currently encumbered. For this indicator, a value of less than 100 % therefore need not imply that the current level of unencumbered assets is lower than the guaranteed deposits.
(3) Communication NBB_2015_18 of 9 April 2015 "Recovery plans – Obligations concerning encumbered assets".
(4) The thresholds set in the Communication may be adjusted in the future, both on the basis of changes in the liquidity rules, used in the definition of the narrow asset encumbrance indicator, and on the basis of any experience concerning false alarms following an overshoot of the current indicator thresholds.
(5) Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010.

Single Resolution Board, all the national resolution authorities of the Member States participating in the banking union, the European Commission and the EU Council.

The BRRD assigns two separate roles to the European Union resolution authorities. First, they are responsible for developing resolution plans for all credit institutions and banking groups, and second they are the ones to manage the resolution process that deals with a bank failure. The SRM Regulation defines the allocation of these tasks and responsibilities between the Single Resolution Board and the national resolution authorities. Thus, the Single Resolution Board is responsible for drawing up the resolution plans and adopting all resolution decisions relating to institutions regarded as significant in accordance with Article 6 of Regulation (EU) No. 1024/2013 [1], known as the SSM Regulation, institutions subject to the direct supervision of the ECB, and cross-border groups. The national resolution authorities perform the same tasks and exercise the same responsibilities in relation to institutions which do not come under the Single Resolution Board remit. The national authorities must also ensure that the decisions of the Single Resolution Board are actually implemented.

The Single Resolution Board comprises a chair, a vice-chair, four other full-time members and a representative of each national resolution authority of Member States participating in the banking union. The chair, vice-chair and the four other full-time members were appointed on 19 December 2014 and took up their duties in the first quarter of 2015.

In 2015, the Single Resolution Board met five times in plenary session. During those plenary sessions, the Board adopted a number of administrative or organisational decisions and defined the policy guidelines on resolution plans, the resolution process and the operationalisation of the Single Resolution Fund. To work out these positions, the Single Resolution Board set up four committees, mainly composed of the Single Resolution Board and the national resolution authorities ; the committees focused respectively on cooperation between the Single Resolution Board and the national authorities, the methodology for developing resolution plans, decision-making and procedures to be followed when an institution goes into resolution, and the Single Resolution Fund. In the future, the Single Resolution Fund is also to manage the European Deposit Insurance Scheme, which is outlined in box 13.

The Single Resolution Board acts jointly with the national resolution authorities. In Belgium, the Organic Law [2] designated the Bank as the national resolution authority. In accordance with the BRRD and in order to ensure segregation between the prudential tasks and resolution activities, the Organic Law established a new body at the Bank, namely the Resolution College, chaired by the Bank's Governor. Apart from the Governor, the Resolution College is composed of the Vice-Governor, the Directors responsible for the Departments in charge of the prudential supervision of banks and stock-broking firms, prudential policy and financial stability, and the resolution of credit institutions, the Chairman of the Board of Directors of the Federal Public Service Finance, the officer in charge of the Resolution Fund, four members appointed by the King by Decree deliberated in the Council of Ministers, and a magistrate appointed by the King. The Chairman of the Financial Services and Markets Authority (FSMA) attends the meetings of the Resolution College in an advisory capacity.

The Royal Decree of 22 February 2015 [3] determines the operating procedures of the Resolution College. It specifies that the Resolution College meets at least four times a year and whenever circumstances so require. The Decree also lays down the arrangements for decision-making, including the quorum requirements. Finally, it also determines the conditions governing the exchange of information by the Resolution College within the Bank and externally.

Since the Decree appointing the Resolution College members was adopted on 10 April, it was possible to hold the first meeting of the College during the second quarter of the year. In 2015, the Resolution College met twice, and on three occasions had to pass decisions by a written procedure.

2.2.2 Legal framework

The major part of the transposition of the BRRD was carried out in 2014 with the adoption of the Banking Law. Certain elements could not be transposed into Belgian law at that time as the new Banking Law was adopted before the finalisation of the BRRD. Those elements therefore had to be transposed later. However, certain provisions of the Banking Law empower the King to complete the transposition of the Directive in some areas. These include elements concerning bail-ins, the treatment of groups, and relations between the authority and third countries.

(1) Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.
(2) Law of 22 February 1998 establishing the Organic Statute of the National Bank of Belgium.
(3) Royal Decree of 22 February 2015 determining the rules on the organisation and operation of the Resolution College, the conditions relating to the exchange of information by the Resolution College with third parties, and the measures to prevent conflicts of interest.

Box 13 – Towards a European Deposit Insurance Scheme

On 24 November 2015, the EC published a draft Regulation on the European Deposit Insurance Scheme (EDIS). In so doing, it laid the foundations for the third pillar of the banking union, alongside the existing single supervision and single resolution mechanisms.

According to the draft Regulation, EDIS is to be phased in between 2017 and 2024. In the first stage (2017-2019), the EDIS will provide limited reinsurance cover for national deposit guarantee systems (DGS) faced with a liquidity shortage upon compensation of depositors whose deposits have become unavailable, or upon having contributed towards the financing of a bank resolution. After this initial provision of liquidity, the DGS will be able to further limit its losses, e.g. by subrogation in the rights of the depositors in the event of bankruptcy. In the end, the DGS will have to reimburse the net losses to EDIS after deduction of a limited contribution from EDIS. To ensure that a DGS is not under-funded compared to the legal requirements of the DGS Directive [1], the contribution from the EDIS is capped at a percentage of the liquidity needs and losses that the DGS would face if it were funded in accordance with the legal requirements. This hypothetical rule is designed to prevent moral hazard.

In the second stage (2020-2023), EDIS will no longer operate as a reinsurer but will act jointly with the DGS as the depositors' insurer. The share of EDIS in this insurance activity will increase from 20 % in 2020 to 80 % in 2023, after which it will be the sole insurer for depositors from 2024 onwards. From then on, the role of the national DGS will be confined to dealing with depositors and banks on behalf of EDIS. Thus, the DGS will compensate depositors and collect contributions from the banks on behalf of EDIS.

The recently revised Directive on deposit guarantee systems is maintained as a single rule book and will be applied by EDIS. The level of cover remains set at € 100 000. The contributions from the banking sector also continue to be risk-based, and the target amount for funding is kept at 0.8 % of covered deposits.

(1) Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

The Royal Decree of 18 December 2015 [1] contains provisions introducing the bail-in tool into Belgian law. Those provisions ensure accurate transposition of the bail-in arrangements laid down in the BRRD. Via a bail-in, shareholders and creditors of the institution being resolved contribute towards financing the institution by having to bear all or part of the losses that they would have suffered if the institution had been wound up under a normal insolvency procedure, i.e. – in Belgian law – a bankruptcy procedure. The scope of these arrangements is specified in the BRRD, which provides for the exclusion of certain creditors (such as depositors covered by the deposit guarantee, i.e. up to € 100 000, or secured creditors). These provisions will have to be applied by the Resolution College in cases where it has sole competence, but also – as a supplement to the provisions of the SRM – by the Single Resolution Board in the case of Belgian credit institutions for which it has competence.

Since the transposition of the BRRD by the Banking Law concentrates on individual credit institutions, it does not deal with aspects concerning the problem of groups or aspects relating to international cooperation. The Royal Decree of 26 December 2015 [2] completed the transposition of these aspects of the BRRD.

The transposition of the BRRD will be finally completed when the provisions on the resolution financing arrangements have been transposed into Belgian law and the scope of the transposed provisions has been extended to investment firms.

2.2.3 Transitional resolution plans

As 2015 can be regarded as a transitional year, the Single Resolution Board asked each national resolution authority

(1) Royal Decree of 18 December 2015 amending the Law of 25 April 2014 on the legal status and supervision of credit institutions.
(2) Royal Decree of 26 December 2015 amending the Law of 25 April 2014 on the legal status and supervision of credit institutions in regard to the recovery and resolution of groups.

in the banking union – including the Bank – to draw up three transitional resolution plans, each intended for a group for which the Single Resolution Board has competence. These transitional resolution plans are the first step towards the development of resolution plans conforming to the BRRD in 2016.

A resolution plan comprises a number of sections. It begins by describing and analysing the institution or group concerned and sets out a range of information as the basis for assessing its critical activities and the way in which they depend on – or are interconnected with – other internal and external functions. The maintenance of these critical functions during resolution is one of the aims of the resolution procedure. Each resolution plan also describes a preferred resolution strategy. The preferred resolution strategy determines the entity or entities (defined as resolution strategy entry points) that will absorb the resolution losses, and defines how the institution or group could be restructured to restore its viability and separate the sound business from the problem activities, or with a view to its partial or total liquidation. In this connection, the resolution plan likewise addresses the question of operational continuity and aspects relating to communication. Finally, it concludes with an assessment of resolvability.

For the purpose of drawing up these plans, the Single Resolution Board set up six pilot projects with internal resolution teams (IRTs) composed of members of the Single Resolution Board and staff of the national resolution authorities covering six different European banking groups. Each IRT aims to devise a resolution plan for the banking group concerned. The Bank took part in two of these IRT pilot projects.

One of the tools which is available to the resolution authorities and must be defined in the resolution plan is the minimum requirement for own funds and eligible liabilities (MREL). The BRRD stipulates that all credit institutions and their parent companies must maintain a certain level of liabilities to which a bail-in can be applied. These consist of capital instruments, provided they are fully paid-up and have a maturity of at least one year, but also certain liabilities held by unsecured creditors with a maturity of at least one year. However, the Directive does not specify the amount of the requirement, which has to be determined case by case.

To regulate the way in which the level of the MREL is determined and harmonise it at technical level, the EBA adopted a draft of the regulatory technical standards on 3 July 2015, defining the methodology to be used to determine the level of that requirement. The draft regulatory technical standards break down the level of the MREL requirement into two cumulative components. The first is the amount necessary to absorb the losses that led the institution or group into a resolution situation. That amount is defined on the basis of the prudential capital requirements. The second is the amount needed to recapitalise the institution or group in the course of the resolution process. That amount, which is likewise based on the prudential capital requirements, can be adjusted downwards if, for example, it is found that the institution or group can be liquidated under normal insolvency procedures and therefore does not have to be recapitalised, or if only part of the activities must be maintained during resolution. It can also be adjusted upwards if it emerges that the level of capital necessary to restore market confidence after a resolution process is likely to exceed the prudential requirements.

In 2015, the Single Resolution Board and the Bank did not determine the individual MREL levels for Belgian institutions for which they are respectively competent since the Single Resolution Board did not formally adopt any resolution plans in 2015. That requirement will gradually be defined in individual cases in 2016 during finalisation of the resolution plans.

Apart from the requirements specific to the European framework, the FSB has also defined the terms of its total loss-absorbing capacity (TLAC), requirement, announced on 9 November 2015 [1]. That requirement applies only to G-SIBs and therefore does not concern the entire scope of the BRRD. Unlike the MREL, the TLAC requirement defined by the FSB is based on the fixing of a minimum threshold. The TLAC requirement is defined as equal to 16 % of the risk-weighted assets from 2019 and 18 % from 2022, or – if that requirement is greater – 6 % of the denominator of the leverage ratio from 2019 or 6.75 % from 2022. Most of that requirement must be met by subordinated liabilities, regardless of whether the subordination is legal, contractual or structural. At least one-third of the requirement must be met by debt instruments. The FSB also stipulates that part of the loss-absorbing capacity must be placed in advance with group entities regarded as material.

In that context, and in order to facilitate the implementation of the TLAC rules, a number of Member States have adjusted the creditor ranking applicable to the insolvency arrangements in order to ensure that certain liabilities subject to a bail-in are subordinated to other liabilities whose contribution to a bail-in would be more problematic. For example, in November 2015, Germany adopted a system

(1) Financial Stability Board (2015), "Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution", *Total Loss-absorbing Capacity (TLAC) Term Sheet*, 9 November.

whereby holders of bonds issued by credit institutions are subordinate to other unsecured creditors of the institution concerned in the creditor ranking. In December 2015, France similarly announced a draft reform of the creditor ranking that aims to divide unsecured creditors into different categories. This reform would make it possible to issue debt securities in a new unsecured category, ranked between subordinated instruments and the category of preferential unsecured liability instruments.

The Royal Decree transposing the bail-in rules into Belgian law does not alter the creditor ranking applicable to a liquidation procedure. Following the drafts adopted or announced in some Member States, the European Commission decided to assess whether it would be desirable to adopt common rules for the European Union. Belgium's position could be modified depending on the European Commission's conclusions and changes to legislation in the other Member States.

2.2.4 Contribution to the Single Resolution Fund

The BRRD requires each Member State to establish a national resolution fund by 1 January 2015. That fund, pre-financed by the levying of contributions from credit institutions and investment firms, should reach a target level of at least 1 % of the total amount of deposits covered by no later than 31 December 2024.

The SRM Regulation establishes the Single Resolution Fund in the banking union on 1 January 2016. It takes the place of the national resolution funds for credit institutions and investment firms covered by that legislation. Its target level is set at a minimum of 1 % of the total amount of the deposits covered for relevant institutions licensed in the banking union (i.e. almost € 55 billion). The fund must be created within eight years.

In 2015, it was for the national resolution authorities to levy contributions to the resolution fund. From 2016, the Resolution Board will take over that responsibility, in collaboration with the national resolution authorities.

The method of calculating the resolution fund contributions is determined by Delegated Regulation (EU) 2015/63 [1]. In order to clarify its implementation in Belgium, the Resolution College adopted a Circular on 23 November 2015. That Circular clarifies the definitions in the Commission's Delegated Regulation and the assumptions and methods used in its application.

Following the adoption of this Circular, the Resolution College notified the various credit institutions and investment firms subject to the Single Resolution Fund of the contributions which they would have to pay in 2015. Those contributions were paid into the national resolution fund which, under the intergovernmental agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, will pay them over to the Single Resolution Fund by no later than 31 January 2016. The Single Resolution Board will take account of the contributions collected in 2015 and transferred to the Single Resolution Fund and deduct them from the amount payable by each institution.

(1) Commission Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to ex ante contributions to resolution financing arrangements.

3. Insurance undertakings

The work on recovery and resolution plans for the insurance sector is still in the development phase at European level. The main reference documents come from the FSB and the International Association of Insurance Supervisors (IAIS), to which the FSB assigned the task of devising policy measures in this field. At FSB level, it concerns the list of global systemically important insurers (G-SIIs) produced in July 2013 and updated in October 2015, and the "Key Attributes of Effective Resolution Regimes for Financial Institutions" published in October 2014. At IAIS level, the document in question is entitled "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers" (in consultation since November 2015). In regard to Belgium, the Bank may, pursuant to the Solvency II Law, require certain undertakings to prepare recovery plans (on this subject, see sub-section 5.1.2 of the chapter on Insurance).

In this context and in parallel with this work, the Bank, as the prudential supervisor of a large Belgian insurer forming part of a group classed as a G-SII (joint decision in July 2013 by the FSB, the IAIS and the national authorities concerned), took part in the work of a Crisis Management Group (CMG) set up at the beginning of 2014 under the aegis of the Autorité de contrôle prudentiel et de résolution (ACPR), the French Prudential Supervisory Authority .

The main tasks of this CMG are :

- validation of a Systemic Risk Management Plan, a document stating the reasons why the group in question was considered as a G-SII and explaining how the group manages those systemic risks ;
- validation of a group recovery plan which includes extreme stress scenarios, clearly defined thresholds and recovery options ;
- validation of a Liquidity Risk Management Plan describing the measures for addressing a liquidity problem within the group ;
- definition of a resolution strategy for the group concerned and drafting of the group resolution plan ;
- carrying out a "resolvability assessment" in order to assess the group's resolvability ;
- in the longer term, introduction of future supplementary capital requirements for non-traditional or non-insurance activities, known as Higher Loss Absorbency Requirements (HLA).

The main subjects discussed by this CMG concern analysis of the group recovery plan (produced by the group concerned). One of the points discussed related to the determination of the critical functions, i.e. functions whose sudden interruption could disrupt the real economy and financial stability. At present, two branches of activity have been classed as "sensitive" from an economic and social point of view, namely the "industrial accidents" branch and branch 21. Another subject discussed was the identification of critical shared services, i.e. services shared within a group and necessary for the performance of critical functions. The work began by determining a set of services featuring that characteristic. These are mainly financial services (cash management, trading activity, asset management, reinsurance, etc.) and operational services (ICT infrastructure, personnel management, etc.).

In regard to definition of the resolution strategy and preparation of a group resolution plan, the current discussions concern the selection of a strategy : TopCo (organising resolution at the level of the holding company at the top of the pyramid) or OpCo (organising resolution at the level of the operating companies). The draft resolution plan comprises two sections : a section on the ultimate parent company at group level and transversal questions, and a section specific to the resolution options feasible for the local entities concerned. In the case of the Belgian insurer, two scenarios were examined : default by the ultimate parent company at group level, and default by the

Belgian entity. In each case, various resolution tools were considered : on the one hand, stabilisation or restructuring instruments (sale or transfer of shares to a third party or a bridge institution), sale or transfer of insurance contract portfolios, branches of activity or total assets, recapitalisation) and on the other hand, instruments for scaling down the business or for orderly winding-up (run-off) and voluntary or compulsory liquidation.

4. Financial market infrastructures

Following the publication of the guidelines concerning the recovery of financial market infrastructures (FMIs) in the report by the Committee on Payments and Market Infrastructures – International Organisation of Securities Commissions (CPMI-IOSCO)[1], the Bank published a Communication clarifying the recovery plan requirements for FMIs[2]. Some FMIs, such as Euroclear Bank, also have bank status and were already obliged to respect the requirements concerning bank recovery plans described above. For FMIs without bank status, there were not previously any detailed recovery plan requirements. The Communication for FMIs is based on that concerning bank recovery plans[3], but tailored to the specific characteristics of FMIs. The main differences compared to the communication for banks concern the sections on "governance" and "strategic analysis". In the Communication on FMIs two additional sections are added, namely "structural weaknesses" and "links between FMIs", and there is provision for the option of sharing information from a cross-border market infrastructure's recovery plan with other authorities concerned.

In regard to governance, FMIs have to add a description of the consultation of the stakeholders (such as participants or linked FMIs). Since the FMI recovery plan may also include the allocation of losses to third parties, it is important that those who will bear the losses are consulted during the development and implementation of the plan. On the other hand, the requirements relating to retail deposits – which FMIs do not have – were deleted.

In the strategic analysis section, the definition of the critical functions was extended to include functions which are necessary for the smooth operation of payment, clearing and settlement systems. The authorities concerned and the stakeholders must also be consulted in the course of identification of the critical functions. In the case of groups, the plan must also include a description of the financial, operational and legal links between the various legal entities within the group. In regard to stress scenarios, the FMIs must take account of not only capital and liquidity shocks but also cumulative business losses, as FMIs obtain most of their income from transaction and custody fees. Apart from traditional recovery instruments such as recapitalisation or access to liquidity sources, FMIs must also include instruments which are specific to them. They must have sufficient financial resources to absorb losses (such as equity capital or a guarantee fund containing money from the participants). These resources have to be pre-financed, which means that FMIs must already have the funds available before the losses materialise. The recovery plan must make provision for instruments to rebuild these financial resources once the buffers are exhausted. FMIs may have other specific recovery instruments such as insurance or indemnity contracts which help to compensate for losses arising from general business, custody or investment risks. Central securities depositories (CSDs) also have to analyse the relevance of instruments for assigning losses to participants, and instruments for transferring critical functions and/or intellectual property rights from an entity in recovery to another viable group entity. FMIs must assess the impact of the recovery instruments not only on their capital, liquidity and profitability but also on the provision of critical services or on other group entities. They must also verify the appropriateness of each recovery instrument on the basis of five specific characteristics:

– Comprehensiveness: the range of recovery instruments must determine exhaustively how the institution is to continue performing its critical functions in all relevant scenarios.

(1) Recovery of Financial Market Infrastructures – Bank for International Settlements and International Organisation of Securities Commissions (October 2014).
(2) Communication NBB_2015_22 of 23 July 2015 – Recovery plans- Specific guidelines for Belgian credit institutions and Belgian parent companies of credit institutions which also have the legal status of a central securities depository (CSD) or institution equivalent to a settlement institution, and for Belgian CSDs which do not have the legal status of a credit institution.
(3) Communication NBB_2015_17 of 8 April 2015 "Recovery plans – Guidelines for credit institutions".

– Effectiveness : each instrument must be reliable and must have a sound legal basis.
– Transparency, measurability, manageability and controllability : instruments must be transparent and designed so that those who may face losses or liquidity shortfalls can measure, manage and control their potential losses and liquidity shortfalls.
– Creation of appropriate incentives for the institution's participants and other relevant stakeholders to monitor the size of the risks that they cause or face in the system and to assess the institution's risk management.
– Negative impact on participants and on the financial system in general is kept to a minimum.

C. Banks

1. Introduction

The year under review was the first full year of operation of the SSM. In practice, this means that seven Belgian banking groups regarded as significant according to the criteria defined by the SSM Regulation are now subject to the direct supervision of the ECB: AXA Bank Europe, Argenta, KBC Group, Belfius Bank, Dexia, The Bank of New York Mellon and Bank Degroof Petercam (formerly Bank Degroof). This last bank underwent a comprehensive assessment during the year. The Belgian subsidiaries and branches of banking groups established in other countries participating in the SSM have the same classification as the banking group to which they belong. Thus, BNP Paribas Fortis and ING Belgium are classed as significant.

For the first time, a Supervisory Examination Programme (SEP) was implemented and the governance of credit institutions was subjected to thematic and horizontal analysis. Section 2 gives more details on these aspects of the new supervision and on the inspections carried out under the SSM.

The ECB paid particular attention to standardising the prudential supervision arrangements. The work started by focusing on the Supervisory Review and Evaluation Process (SREP) and resulted in the definition of the additional capital requirements for individual institutions ("pillar 2 requirements"). After that, it concerned the harmonisation of the options and national discretions. These two aspects and the other work of harmonisation, both quantitative and qualitative, are described in section 3.

When harmonising prudential supervision practices and regulations, it is necessary to take account of the principle of proportionality. Apart from that challenge, good cooperation and mutual confidence between the national authorities and the ECB are vital to ensure high-quality supervision under the SSM. Furthermore, it is appropriate to make use of the national authorities' expertise in the exercise of supervision. Finally, the development of procedures – which is inevitable in the initial stage of the SSM and demands much attention – must not be at the expense of regular risk analysis. It is also important to supplement supervision at consolidated level with more granular analyses of the main subsidiaries of large banking groups.

The new microprudential supervision framework was introduced against the backdrop of continuing preparation and implementation of the national and international regulations (discussed respectively in sub-sections 4.1 and 4.2 of this chapter) and work on the quantitative and qualitative information that credit institutions are to submit periodically to the competent authorities (see sub-section 4.3). During the period under review, due attention was also paid to the governance of credit institutions; this was reflected, for instance, in the drafting of a governance handbook and a new detailed horizontal analysis of compliance with the rules on the remuneration policy (see sub-section 4.4).

2. Mapping of the sector and operational aspects

2.1 Population

The Belgian banking landscape was again fairly stable in 2015, with a small decline in the number of branches. In the case of investment firms, there was no change.

One Belgian bank exited the sector following the split after cessation of its business, while – for the first time in years – one new Belgian bank was registered, namely MeDirect Bank SA/NV. This new bank is the result of the conversion of the Belgian subsidiary of Mediterranean Bank, a Maltese credit institution, into a fully-fledged Belgian credit institution. This new credit institution was regarded as a less significant institution when it was licensed, but will be transferred to the significant credit institutions category from 2016 because, following a takeover, the banking group to which it belongs is now considered a significant institution according to the SSM criteria, Consequently, the Belgian subsidiary and the Maltese parent company and other licensed group entities now come under the direct supervision of the ECB, and the Bank will become a member of the Joint Supervisory Team (JST) set up for the purpose under the SSM.

TABLE 2 NUMBER OF INSTITUTIONS SUBJECT TO THE BANK'S SUPERVISION

	31-12-2014	31-12-2015
Credit institutions	119	116
Under Belgian law	37	37
Branches governed by the law of an EEA member country	56	52
Branches governed by the law of a non-EEA member country	10	10
Financial holding companies	6	7
Financial services groups	4	4
Other financial institutions [1]	6	6
Payment institutions	34	34
Under Belgian law	20	20
Branches governed by the law of an EEA member country	12	12
Financial holding companies	2	2

Source: NBB.
(1) These are specialist subsidiaries of credit institutions and credit institutions associated with a central institution with which they form a federation.

In 2015, the ECB also classed the Belgian bank Degroof Petercam (formerly Banque Degroof) as a significant institution on account of its cross-border activities. In accordance with the SSM rules, it subjected the bank to a comprehensive assessment of its financial situation, comprising an asset quality review (AQR) and a stress test. That exercise did not reveal any solvency problems, but offered the opportunity to assess the specific characteristics of the lending practices of that institution – which specialises in discretionary asset management – in the light of the general SSM methodology. The conclusions of that assessment will be taken into account in the regular supervision.

The table lists the Belgian population of credit institutions incorporated under Belgian law, without their branches, grouped according to the classification criteria of the SSM Regulation.

2.2 Supervision programme

Since the entry into force of the SSM, much of the Bank's supervisory work concerning Belgian credit institutions

TABLE 3 BELGIAN CREDIT INSTITUTIONS GROUPED ACCORDING TO THE SSM CLASSIFICATION CRITERIA

Significant institutions	Less significant institutions (7.0 %)
Belgian parent (54.7 %)	Byblos Bank Europe
Argenta	CKV
AXA Banque Europe	CPH
Belfius	Crelan (Crelan, Europabank, Keytrade)
Degroof Petercam	Dierickx, Leys & C°
Dexia	ENI
KBC (KBC Banque, CBC)	Euroclear
Non-Belgian SSM-member parent (35.3 %)	Finaxis (ABK, Delen, Van Breda)
BNP Paribas (BNP Paribas Fortis, Bpost banque)	Nagelmackers
Crédit Mutuel (Beobank, BKCP, Banque Transatlantique)	Optima Bank
ING (ING Belgium, Record)	Shizuoka Bank
Banca Monte Paschi Belgio	United Taiwan Bank
MeDirect (2016)	van de Put & C°
Puilaetco Dewaay Private Bankers	VDK Spaarbank
Santander	
Société Générale Private Banking	
Non-Belgian non-SSM member parent (3.0 %)	
Bank of New York Mellon	

Source : NBB.
The figures in brackets are the market shares calculated on the basis of the consolidated balance sheet totals.

classed as significant is shared with the ECB. The SSM provides for close cooperation between the ECB and the national competent authorities (NCAs), and JSTs have been set up for that purpose for each significant Belgian banking group.

In 2015, these JSTs implemented for the first time a supervisory examination programme (SEP) drawn up at ECB level and approved by the Supervisory Board at the end of 2014. This programme, designed to be applicable to all large European banking groups, was converted into an individual programme for each credit institution, to take account of each institution's size, specific characteristics and the general risk score which it was given in 2014 at the end of the comprehensive assessment to which it was subject in that year.

The SEP comprises various types of work, the frequency and scale of which depend on the factors mentioned above. It includes the preparation of periodic follow-up reports by type of banking risk, the arrangement of interviews with managers and representatives of the credit institution's key functions, and the organisation of detailed thematic reviews conducted simultaneously in all institutions subject to direct ECB supervision. All this work contributes to the annual risk assessment and the assessment of the adequacy of the institution's solvency and liquidity position.

Of course, the implementation of this first programme of supervision at European level entailed adjustments at the level of both the ECB and the Bank, as initial problems emerged in the learning phase. Usually, this concerned the development of the methodologies and adjustment of procedures to local requirements and specific characteristics. In Belgium, for example, the supervision of significant subsidiaries of large banking groups subject to supervision on a consolidated basis plays a dominant role. This was the subject of much discussion in the various networks of experts and in the JSTs. The implementation of individual supervision programmes for each institution also entailed coordination to ensure both the continuity and the consistency of prudential practices at national level. Finally, to ensure the success of the SSM and the maintenance of effective cooperation between the NCAs and the ECB, the Bank kept – and will continue to keep – a close eye on the operational implementation of the matrix organisation involving functional links between the local teams and the ECB, while keeping the existing hierarchical links with the Bank.

In regard to the less significant banks, the Bank is in the front line for conducting the supervision programme. Since the ECB also carries ultimate responsibility for these banks too, the SSM monitors these local and specialist banks at the second level, and agrees arrangements with the national supervisory authorities in order to adopt the same approach as far as possible in conducting the supervision. Furthermore, in developing its supervision instruments for this group of credit institutions, the Bank systematically checks whether such instruments already exist at the ECB (e.g. for supervising significant institutions) and whether they are applicable, taking account of the required proportionality, to smaller local and specialist institutions. In so doing, the Bank endeavours to make efficient use of resources and also intends to avoid any discrepancy between the supervision practices and instruments used for significant institutions and those applied to less significant institutions.

2.3 Governance and aptitude testing

Since the entry into force of the new Banking Law, the Bank's supervision has become even more important in every aspect relating to bank licensing, and more particularly the assessment of the expertise and professional integrity of bank executives and officers responsible for key functions, such as internal audit, risk management, compliance ("fit & proper" checks), on the one hand, and the assessment of potential acquirers in the event of changes to the capital structure.

Although, since the start of the SSM, the ECB takes the final decision on some institutions, the Bank and the ECB conduct this analysis jointly, with the Bank concentrating primarily on compliance with the specific provisions introduced by the Belgian legislature in transposing the CRD IV into the Banking Law.

The required aptitude is assessed on the basis of the criteria and procedures laid down by the Belgian legislation, namely the Banking Law and the guidelines specified in a Circular [1], and the points for attention emerging from the collaboration with the ECB. More specifically, as regards the assessment of the candidates' expertise, particular attention focuses on the training programmes offered by the institutions to inform candidates about the institution concerned and, where necessary, to update their technical knowledge in various fields. Candidates must also demonstrate that they can devote sufficient time to their duties; in the case of credit institutions classed as significant pursuant to Article 3, 30°, of the Banking Law, account must also be taken of the restrictions on the number of mandates defined by Article 62 of the Law. Other points for attention concern the required collective expertise of the management board or advisory committees and the existence of a policy for identifying and managing conflicts of interest. This refers not only to conflicts of interest relating to personal or professional circumstances, but also conflicts of interest in regard to directors proposed by the government, e.g. as shareholders or in connection with state aid.

Since governance is also one of the SSM's main priorities, the SSM had planned to conduct an in-depth analysis in 2015 on the governance of the banks subject to its supervision. The thematic analysis was conducted at consolidated level, but some subsidiaries classed as significant were also included in the exercise. It covered two topics: the operation of the banks' management bodies (board of directors and executive committee) [2] and the risk acceptance framework [3] defined for pursuing their activities. The thematic analysis was conducted with due regard for national provisions on governance and risk management, but also took account of the recommendations issued on the subject at international level (such as the guidelines on corporate governance principles for banks, laid down by the Basel Committee in July 2015). The JSTs analysed the credit institutions' documents and minutes and met their senior management in order to form an opinion on the quality of the governance and on the risk appetite of each credit institution concerned. In some cases, the JSTs attended a meeting of the board of directors as observers, which enabled them to assess the information presented to members of the board, the interaction between the executive and non-executive directors, and the quality of the discussions that precede decision-making.

In general, as regards governance (composition and organisation of the board of directors), the Belgian banks perform better than the average for all credit institutions under the SSM. Conversely, the assessment of the framework for risk acceptance shows that the Belgian banks need to go into more detail in their discussions and produce more formal documentation on the subject. The "risk" committee that has to advise the board of directors should be able to make a contribution here.

In any case, good governance will always be an important point for attention. This thematic analysis will have enabled the ECB to assess the governance situation in each significant bank in the SSM, but also to determine

(1) Circular NBB_2013_02 of 17 June 2013.
(2) Organisation, composition, quality of documentation and minutes, account taken of the "risk" dimension in discussions.
(3) Quality of the risk appetite framework, assessment of limits and indicators, governance and strategy followed.

reference indicators for banks with a similar profile (benchmarking exercise) and identify good governance practices, adherence to which will be promoted and encouraged in the future.

2.4 Inspections conducted under the single supervisory mechanism

The on-site inspections are detailed investigations into institutions for the assessment of the various risks to which they are exposed and the adequacy of the existing accompanying measures and supervision. The decision to conduct an on-site inspection is generally taken within the framework of a supervision plan, and specific procedures and techniques are followed for the inspection.

Inspections of significant institutions are conducted in accordance with the procedures laid down by the SSM, whereas the national authorities remain responsible for inspecting less significant institutions, with due regard for the guidelines and inspection methodology issued by the ECB.

The procedures concern:

- definition and objectives of the inspections;
- their organisation;
- inspection concepts and techniques;
- the procedures applicable to the various stages of an inspection (planning, preparation, execution, report, follow-up and review).

The inspections are conducted by teams appointed by the ECB and composed of staff of the national competent authorities and the ECB. The 'heads of mission' are generally staff of the national competent authorities and must not be members of the full-time supervision teams.

The SSM inspection methodology describes the objectives for the main inspection themes, and the recommended inspection techniques for each objective. The guidance provided by the methodology forms the basis of all inspections in the SSM, and all inspections must expressly refer to that. The methodology is continuously supplemented and adjusted by the ECB in consultation with the national competent authorities.

3. Single Supervisory Mechanism

3.1 Key projects

While the preparatory phase of the single supervisory mechanism had been dominated by the comprehensive assessment of significant banks and therefore needing to be subject to direct ECB supervision, and by the operational and organisational implementation of the single supervisory mechanism, the year under review – which was the first year of the SSM – was devoted primarily to following up that assessment and developing harmonised prudential policies and supervision practices.

In particular, the harmonisation of the options and national discretions (ONDs) available to the national authorities under the CRD IV/CRR is an important aspect of the development of the single rule book. The harmonisation of the methodologies for risk assessment and for the evaluation of solvency and liquidity positions is also a key element in the convergence of the Supervisory Review and Evaluation Process (SREP) relating to the additional capital requirements, known as pillar 2 requirements. However, the harmonisation work is not confined to these aspects, but covers numerous areas of prudential supervision, both quantitative (validation of internal models, dividend payment policy, etc.) and qualitative (governance and remuneration policy, inspection methodology, etc.).

Monitoring of the financial situation of the Greek banks and the new comprehensive assessment of those banks formed an important part of the maintenance of stability within the SSM during the year under review.

Also in that year, institutions which were considered as significant at the end of 2014, including Bank Degroof Petercam (formerly Bank Degroof), underwent a comprehensive assessment.

3.2 Main developments and decisions on supervision

3.2.1 SREP decision and methodology

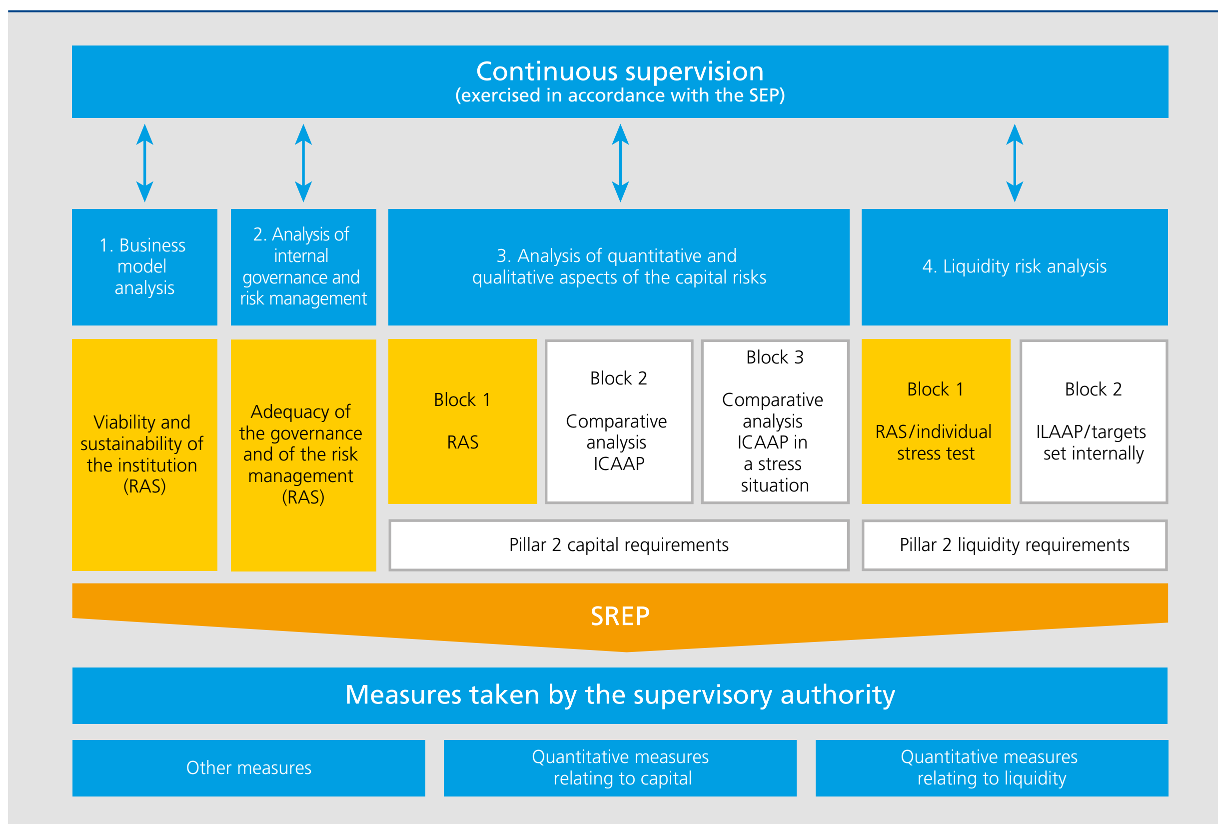
In 2015, the banks subject to SSM supervision adopted the SSM approach to the SREP for the first time. That process comprised four stages. Following an SREP analysis of the individual banks conducted by the JST, horizontal analyses were used to examine consistency between the individual dossiers. In September and October of the year under review, the individual SREP dossiers were discussed with the institutions concerned, after approval by the Supervisory Board. In November 2015, following the period in which the institution had the right to be heard, the SREP decisions on capital and liquidity were again submitted to the Supervisory Board and then to the Governing Council for final approval.

The methodology used follows the SREP guidelines published by the EBA in December 2014 [1] and involves a holistic approach which lists, analyses and quantifies the various aspects of banking risks. The ultimate aim is to conduct a full assessment of the material risks facing the institution and to quantify the capital and liquidity requirements, with the option of imposing specific supervision measures in that respect too.

The first element of the SREP approach is a quantitative and qualitative assessment by the supervisory authority of the risks facing the institution, using the Risk Assessment System (RAS). On the basis of certain indicators of general banking risks, an automatic calculation generates (risk) scores. The risks are then the subject of a much more

(1) EBA/GL/2014/13: Guidelines on Common Procedures and Methodologies for the Supervisory Review and Evaluation Process (SREP).

CHART 3 DIAGRAM OF THE SREP APPROACH



Source: ECB.

detailed and substantiated expert analysis which takes account of the various risk dimensions, and if necessary the JST adjusts the automatically calculated scores.

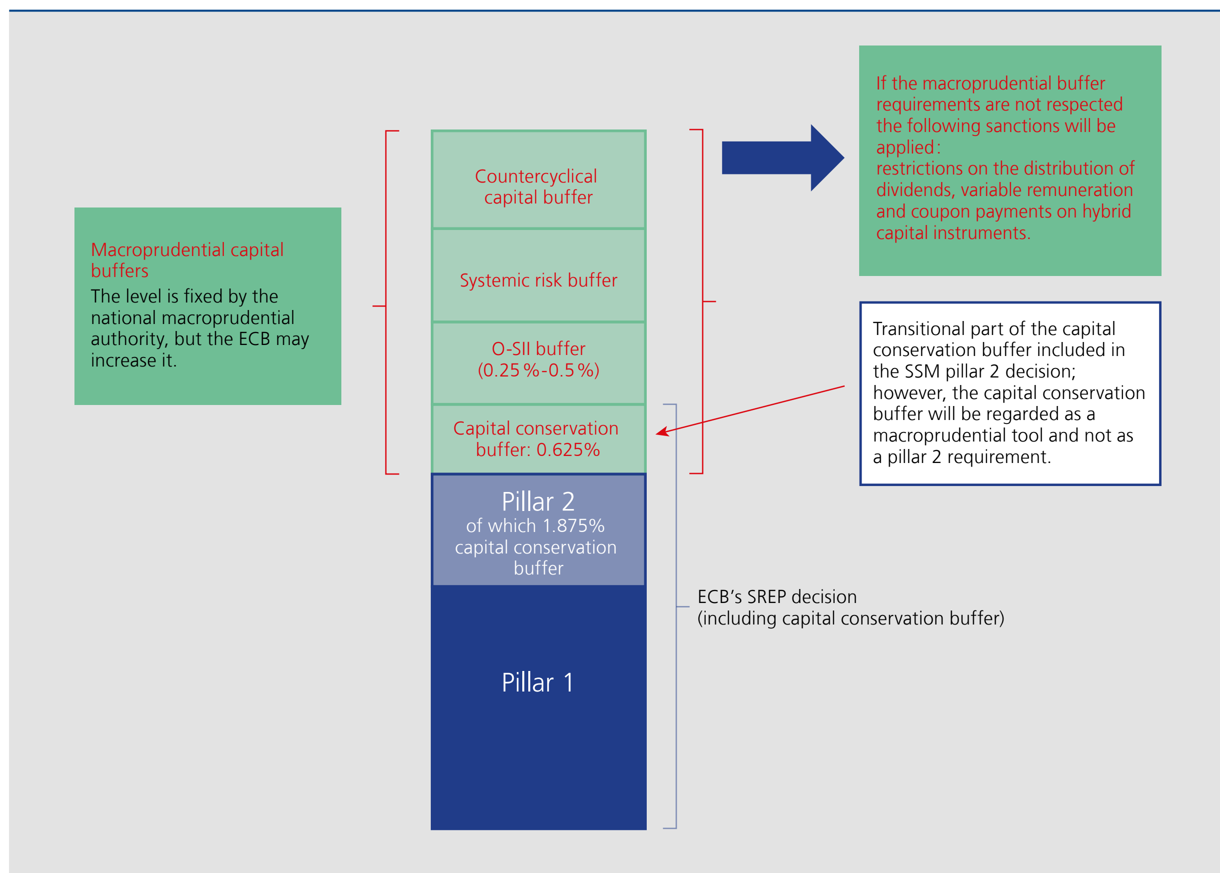
For the purpose of determining the capital and liquidity requirements, the methodology is based not only on the RAS but also on an Internal Capital Adequacy Assessment Process/Internal Liquidity Adequacy Assessment Process (ICAAP/ILAAP)[1], and on checking the assessments and quantifications of the institution's risks with the aid of benchmarks and proxies. In addition, stress tests are conducted over a set timescale (between three and five years, for example) to estimate how the capital and liquidity profile will change in the years ahead and to improve the detection and quantification of any vulnerabilities.

The Supervisory Board formulated some important strategic clarifications in regard to capital requirements under the SREP. First, the SREP requirements must be covered by CET 1 capital, since that is better able to absorb shocks. Next, CET 1 capital must first and foremost be used to cover the pillar 1 requirement and the pillar 2 requirement before it can be allocated to compliance with the macroprudential capital buffer requirements, whether it be the capital conservation buffer or the other buffers imposed when systemic risks emerge. Consequently, in the event of failure to comply with the overall pillar 1 and pillar 2 requirements and the macroprudential capital buffers, the distribution of dividends and variable remuneration and the payment of coupons on hybrid capital instruments must be limited pursuant to the provisions of the CRD[2]. The ECB thus specified in its Recommendation of 28 January 2015 on dividend distribution policies that it expected institutions which did not respect the total requirements of pillars 1 and 2 and the buffers applicable to refrain from distributing dividends. In accordance with that Recommendation, it notified the institutions, via the SREP decisions, that the necessary measures would be

(1) The institution's ICAAP comprises the processes and strategies for continuously analysing and ensuring the adequacy of the internal capital in terms of quantity, type and distribution, taking account of the risks to which the institution is exposed or which it may encounter. The ILAAP encompasses the institution's processes and strategies for ensuring that it has adequate liquidity reserves at all times to cover the potential liquidity risks.

(2) Article 141 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012

CHART 4 CET 1 CAPITAL REQUIREMENTS



Source: NBB.

taken if their capital margin in relation to the total requirements [1] was less than 25 basis points.

Overall, following this harmonisation, the 2015 CET 1 requirements for banks under the SSM (applicable in 2016) increased by an average of 46 basis points, compared to the 2014 requirements (applicable in 2015). Thus, the pillar 1 and 2 requirements – including the capital conservation buffer – increased from 9.7 % in 2015 to 10.1 % in 2016. In addition to these requirements, there are the other macroprudential buffers imposed by the various national competent authorities. The national macroprudential authorities have very often supplemented the above requirements with additional requirements to take account of the systemic dimension of credit institutions at national level or to reduce certain emerging structural or cyclical systemic risks. Those requirements will generally be phased in over the period 2016-2019.

In the case of the Belgian banks, the microprudential requirements for CET 1 have been reduced. Thus, on average, the sum of the pillar 1 and pillar 2 requirements – including the capital conservation buffer – declined from 12.1 % in 2014 (applicable in 2015) to 10.25 % in 2015 (applicable in 2016), the reason being that the Bank has already in the past demonstrated the necessary prudence when determining the pillar 2 requirements, and in so doing has also taken account of certain systemic dimensions. As stated in chapter A of the Report in the section on "Prudential regulation and supervision", the Bank classified eight domestic banks as systemically important institutions and decided to impose an additional capital requirement on those Belgian institutions, ranging between 0.75 % and 1.5 %. That additional capital buffer requirement will be phased in between 1 January 2016 and 1 January 2018 at the rate of one-third of the required amount each year.

3.2.2 Options and national discretions

Both the CRD and the CRR and the delegated acts which supplement them make provision for a number of ONDs

(1) Namely the sum of the pillar 1 and pillar 2 requirements and the buffer requirements (CET 1).

CHART 5 OVERALL CAPITAL REQUIREMENTS FOR BANKS[1]
(CET 1, in %)

Sources: ECB, NBB.
(1) The 2014 (2015) requirements apply in 2015 (2016). These are unweighted averages. The average for Belgium concerns the banks classed as significant, including BNP Paribas Fortis and ING Belgium.

for the competent supervisory authority and/or the Member States.

Now that the ECB has become the competent authority for significant credit institutions in the euro area, it has embarked on the necessary work of specifying how these ONDs available to the supervisory authority should be applied. In the course of this work, the ECB has distinguished between the options and discretions which will apply to all credit institutions in general and those which may be used case by case on the basis of a dossier submitted by the institution.

The ECB's aim is to harmonise prudential treatment at the level of the euro area; that is essential to ensure fair treatment for all credit institutions, and also tends to make it easier to supervise them. The comprehensive assessment conducted in 2014 showed that divergences in the use of the ONDs within the euro area were creating substantial differences in solvency ratios between credit institutions. Those divergences were due in particular to differences in the use of the transitional measures laid down by the CRR. In this harmonisation exercise, the ECB has generally adopted a prudent approach, defining strict criteria for the use of national discretions, taking account of the best practices followed by the various euro area supervisory authorities and, as far as possible, respecting the international standards defined by the Basel Committee. The ECB has also taken account of the legitimate expectations of credit institutions in not systematically modifying all the national rules to which they are subject.

On 11 November 2015, following completion of this work, the ECB published two consultation documents aimed at harmonising the arrangements for exercising the 122 options and national discretions available to the competent authorities. The first document is a draft Regulation intended to harmonise the arrangements for exercising 36 general options and national discretions. The main ones concern the CRR transitional measures relating to the definition of own funds. In that regard, the ECB draft Regulation makes provision, in particular, for a transitional regime limited to five years for the deduction of deferred tax assets from own funds, except in the case of banks subject to restructuring plans, while some national authorities had decided, in accordance with the CRR, to adopt a ten-year transitional period for deferred tax assets in existence on 31 December 2014. The second document is a Guide clarifying the policy and criteria that the ECB actually follows to decide on the use of ONDs that have to be exercised case by case. This notably concerns the option of not deducting insurance holdings from credit institutions' own funds, or waiving the limit on significant risks for cross-border intra-group exposures. In that connection, the ECB clarified the exemption criteria laid down by the CRR and the criteria for exempting institutions from compliance with the short-term liquidity coverage ratio (LCR) at company level in cases where they constitute sub-groups of entities managing their liquidity centrally. In such cases, the LCR must be respected at the level of the sub-group as a whole. However, the ECB stipulates that institutions forming part of such sub-groups must individually maintain sufficient liquidity to fulfil 75 % of the LCR. With a view to finalising the implementation of the banking union in the euro area, it will review that rule in 2018 in the light of its practical experience, with due regard for institutional developments.

On the basis of the outcome of the public consultation which ended in mid-December 2015, the ECB will finalise its Regulation and its Guide so that both can apply from March 2016. It will also continue to examine the options and national discretions not yet covered by the Regulation and Guide.

In that connection, it should be noted that this is not a question of total harmonisation of the prudential rules,

as the Regulation and Guide will apply only to significant institutions and subject to direct ECB supervision, and ONDs offered to the Member States rather than the competent authorities are not included in this harmonisation exercise.

In the case of the Belgian credit institutions subject to direct ECB supervision, this Regulation should not imply any fundamental change in the current framework. In fact, most of the options adopted by the ECB correspond to options used in Belgium pursuant to the National Bank of Belgium Regulation of 4 March 2014 on the implementation of the CRR. The transitional measures adopted in Belgium are generally in line with the options proposed by the ECB, except for the deduction of unrealised losses on available-for-sale (AFS) securities issued by sovereign EU Member States. In their case, the Belgian Regulation offered the option of not deducting the losses if they did not exceed 5 % of the face value of the portfolio of securities in question. Also, the ECB did not question the option of not deducting insurance holdings from the own funds of credit institutions, an option which is widely used in Belgium and in other Member States.

In addition, in accordance with the option that the CRR offers to Member States, the limit of 100 % of own funds was maintained for cross-border intra-group exposures in relation to parent companies and sister companies of Belgian credit institutions.

The Bank likewise decided to maintain until 1 January 2017 at the latest the obligation to respect the CRR's LCR in full, both on a solo basis and on a consolidated basis. After that date, the rules defined by the ECB can be applied, and institutions will be able, if appropriate, to apply for exemption from the obligation to respect that liquidity ratio in full on a solo basis if they constitute or form part of a sub-group managing its liquidity centrally and they respect the criteria laid down by the CRR and the ECB. Belgian institutions also remain subject to the general solvency requirement (gearing ratio) laid down by the Regulation dated 4 March 2014, pending the application of a minimum leverage ratio at European level.

In order to ensure equal treatment between Belgian institutions classed as significant and those considered less significant, the Bank decided to adapt the Regulation of 4 March 2014 in order to align the various provisions.

3.2.3 Miscellaneous

To preserve the renewed confidence in the European banking sector, the SSM continued its efforts to put the euro area's banking sector on a sound footing, taking account of the weaknesses detected in some banks, particularly those which had failed the comprehensive assessment. The ECB thus monitored the capital plans adopted by those institutions to restore their solvency position. In that regard, particular attention focused on the viability of their business models and the adequacy of the provisions, taking account of the very high level of non-performing loans in some Member States. The persistence or even continuing growth of these non-performing loans seriously weakens banks' profitability and is a major hindrance to the recovery of economic growth. Against that backdrop, the SSM set up a task force to identify good practices relating to the resolution of these loans and the obstacles – particularly legal ones – hampering their resolution. The entry into force of the BRRD on 1 January 2016 could make it considerably harder to resolve these bad debts – particularly by setting up 'bad banks' granted government aid – in view of the implications of state aid for the credit institutions concerned. Thus, from 1 January 2016, all state aid must be preceded by the application of a bail-in as defined by the BRRD and – save in exceptional circumstances – the outcome will always be the resolution of institutions which have received state aid.

The ECB also conducted a new comprehensive assessment which, as in 2014, was based on two complementary pillars : an asset quality review (AQR) and stress tests. The ECB conducted the exercise on the basis of a harmonised methodology designed to promote convergence in the definition of prudential concepts and rules, and in supervision practices. Two types of institution were involved. First, there were the institutions which had not been subjected to this exercise in 2014 because they had not been designated as significant until after the list was drawn up in September 2014. The Belgian credit institution Bank Degroof Petercam (formerly Bank Degroof) took part in this exercise in 2015 with eight other institutions subject to the SSM, and passed all the elements of the comprehensive assessment as described in section 2.1 of this chapter.

Furthermore, in view of the precarious financial situation of a number of Greek banks, pursuant to the agreement reached by the Eurogroup in August 2015, the ECB was also given the task of determining the capital needs of those institutions classed as significant. Under the financial plan totalling € 86 billion, a maximum of € 25 billion can be devoted to improving the financial situation of those banks and absorbing their resolution costs, in return for the application of a degree of risk-sharing with their shareholders and creditors. To avoid serious contagion risks and an even greater deterioration in economic activity, depositors were not subject to this risk-sharing. To meet the Eurogroup's requirements, the ECB conducted

a new comprehensive assessment for those banks, taking account in particular of the significant degradation of their loan portfolios and liquidity position. The initial results of that exercise for banks considered significant indicated a capital need amounting to € 14.4 billion. In addition, the capital plan submitted by those institutions should make it possible to reduce the intervention of the European Stability Mechanism to € 5.43 billion.

In response to the many questions raised in recent years concerning the consistency of the capital requirements indicated by internal models, the SSM launched a project for the horizontal assessment of those internal models. That project, called the TRIM (Targeted Review of Internal Models), was prepared in 2015. It will concentrate on the assessment of a range of key factors likely to lead to insufficiently consistent results. All "suspect" topics will be taken into account, ranging from clarifications of the legislation to the qualitative and quantitative aspects of internal models. The year 2016 will be devoted to off-site analyses of the transversal aspects (clarifications of the legislation and qualitative factors), and on-site assessments of the quantitative elements will be conducted in 2017 and 2018. A representative sample of the models will undergo an on-site assessment. This project will make it possible to reduce unwarranted variations in the risk-weighted assets and to check whether the results of the internal models are sufficiently consistent.

4. Continuing implementation and development of national and international legislation

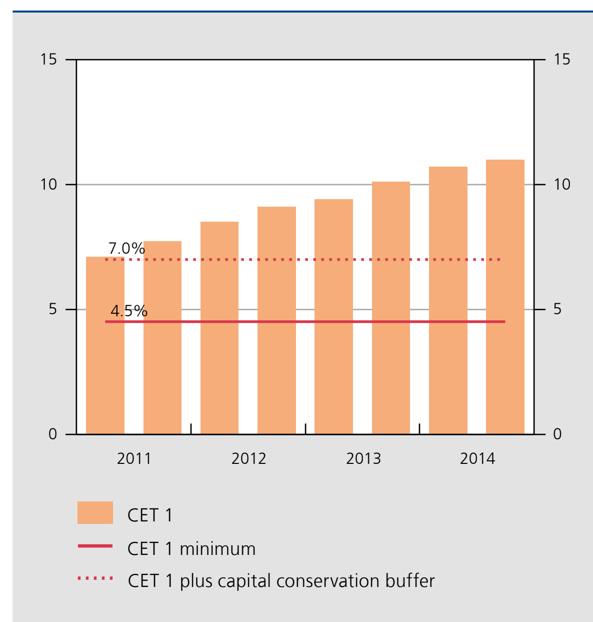
4.1 International regulations

The introduction of the Basel III framework remains fundamental to the construction of a robust financial system, the maintenance of public confidence in bank regulation, and the guarantee of fair competition between banks operating internationally. Monitoring of the implementation of these regulatory reforms therefore remains a priority for the Basel Committee.

During the year under review, the Basel Committee continued to work on its programme of scanning the introduction of the new regulatory standards by individual supervisory authorities. Under the Regulatory Consistency Assessment Programme launched by the Committee, the implementation of the rules on both capital and liquidity forming part of the Basel III package was assessed for the countries forming part of the Committee.

In analysing the impact of the entry into force of this new prudential framework, the Basel Committee continues to base its views on six-monthly impact studies concerning capital requirements (both risk-weighted solvency ratios and the leverage ratio) and liquidity criteria in all banks of the countries which are members of the Basel Committee. Since the launch of the Basel III standards, there has been a general, gradual improvement in both capital and liquidity ratios. The data for the end of December 2014 show that, for the first time, all the large banks operating internationally respected the minimum CET 1 ratio (7 % + any buffers for systemically important banks). Under the current prudential framework, the CET 1 ratio averaged 11.7 % for large internationally active banks. The big Belgian banks recorded a higher average CET 1 ratio. The average Basel III leverage ratio, defined as the ratio between the Tier 1 capital and the total assets plus part of the off-balance-sheet positions, came to 5.0 % for large banks operating internationally. The Belgian banks included in this sample recorded a leverage ratio which was slightly lower on average than that of their international counterparts.

CHART 6 BASEL III CET 1 RATIOS FULLY IMPLEMENTED: AVERAGE FOR LARGE INTERNATIONALLY ACTIVE BANKS
(in %)



Source: Basel Committee on Banking Supervision.

A similar picture emerges for the banks' liquidity situation : since the completion of the two Basel III liquidity standards, both the LCR and the long-term structural liquidity ratio – the net stable funding ratio (NSFR) – have increased considerably. While the LCR determines whether a bank has sufficient liquid assets to withstand a liquidity stress scenario for one month, the NSFR indicates whether a bank has sufficient long-term funding to finance illiquid assets. At the end of December 2014, the LCR averaged 125.3 % for large banks operating internationally, while 81 % of the banks in the sample already had an LCR of more than 100 %. The NSFR stood at 111.2 % for that group of banks, and 75 % of those banks already had an NSFR of more than 100 %. On average, the Belgian banks in that sample had liquidity ratios slightly higher than their international counterparts.

As well as monitoring the implementation of the Basel III standards, the Basel Committee continues to work on improving the consistency of the capital requirements. Benchmark studies conducted by the Committee on the calculation of the capital requirements by banks confirmed that there are significant differences between the banks' regulatory capital ratios, owing to factors unconnected with the underlying risks of the banks' portfolios. Those differences raise questions about the methods of calculating risk-weighted capital ratios. In response, the Basel Committee is working on a range of policy and supervision measures to supplement the Basel III package, in order to limit the excessive variability of the capital requirements calculated on the basis of a bank's internal models. The focus of the current work, scheduled for completion by no later than the end of 2016, is therefore on the denominator of the general risk-based capital coefficient, i.e. the methods of calculating the risk-weighted assets.

To this end, the Basel Committee is first devising specific measures to improve the system of calculating the capital requirements for operational, credit and market risks on the basis of internal models. The changes in question will limit the available model parameters and choices, particularly for portfolios or risk types which, by their very nature, are less suited to modelling.

A second measure is the revision of the standardised approach for the calculation of the capital requirements for operational, credit and market risks. The Committee has continued to work on this revision on the basis of proposals published earlier. On completion, these revised standardised approaches will form the basis for establishing a floor for the capital requirement calculated on the basis of internal models which should ensure that the capital requirements based on internal models are maintained at a prudent level.

A third measure concerns the introduction of a leverage ratio which does not involve risk-weighting of assets. Although a risk-weighted capital requirement is very important, it cannot prevent institutions with low-risk assets from relying very heavily on debt financing. The leverage ratio rectifies that. In the event of financial difficulties, excessive debt financing may lead to a forced debt reduction and the fire sale of assets, triggering a fall in the price of those assets and financial losses, and potentially destabilising the financial system. The Basel III measures provide for the introduction of a minimum leverage ratio from 2018. That leverage ratio is currently still an observation ratio, but it must be made public by credit institutions. Public disclosure of the leverage ratio is compulsory from the year under review, at the same time as the publication of the institution's financial reports. For institutions reporting quarterly, this must therefore be done from the publication relating to the first quarter of 2015. Since mid-2011, a sample of institutions have already been reporting the leverage ratio to the supervisory authorities. On the basis of the information gathered during this observation period, the Basel Committee is examining whether final adjustments should be made to the definition, calibration and minimum level of the leverage ratio requirement. It is also examining the degree to which the leverage ratio can be used as a macroprudential instrument by the possible introduction of additional buffer requirements for this ratio. At the meeting of the Group of Central Bank Governors and Heads of Supervision on 10 January 2016, it was decided that the leverage ratio should be calculated on the basis of the Tier 1 capital and must equal at least 3 %. Requirements concerning additional buffers for G-SIBs were also discussed.

At European level, the EBA is to report by the end of October 2016 on the impact and effectiveness of the introduction of a binding leverage ratio in the European context, in order to establish a final definition and a minimum requirement for the leverage ratio as a mandatory capital requirement for European banks by 2018. That report includes an analysis of the extent to which the minimum required level and the reporting requirements should be differentiated according to the size, business model and risk profile of the institutions. It also examines the interaction between the leverage ratio and other prudential requirements such as the risk-weighted capital ratio and the liquidity requirements, and the possible impact on the financial markets of the introduction of a leverage ratio.

A fourth and final Basel Committee measure to limit the excessive variability of the capital requirements is the increase in the transparency of the bank balance sheet, activities and risks. In that respect, the year under review

saw the finishing touches to new guidelines on the information that credit institutions have to disclose.

Apart from this work on following up the implementation of the Basel III standards and limiting the variability of the risk-weighted assets, there were some important regulatory developments concerning the prudential treatment of securitisation operations. A key point here is the Basel Committee's revision, in December 2014, of the framework relating to the capital requirements for credit institutions' securitisation positions. That revised framework, which will enter into force in January 2018, is a major step forward in the completion of Basel III.

At the same time, the Capital Markets Union aims to improve the financing of the real economy through capital markets in Europe. Securitisation is an important element of that initiative, being perfectly in tune with its objectives. With that in mind, in connection with the action plans announced at the end of September 2015, the EC published its proposal for legislation on a new harmonised European securitisation framework. That framework will replace all the sectoral regulations on securitisation and will also create a standard for simple, transparent and standardised securitisation in the EU. The preferential prudential treatment of this type of securitisation by credit institutions and investment firms will be implemented via amendments to the CRR.

Other more specific measures under the Capital Markets Union Action plan are a consultation on covered bonds, adjustments to the Solvency II calibrations for investment by insurers in infrastructure projects and European long-term investment funds, and proposals for modernising the Prospectus Directive in order to facilitate access to public contracts.

In the prudential sphere, the call for evidence on the cumulative impact of the financial reforms is a significant initiative under the Capital Market Union Action Plan. It aims to assess the impact of the CRR and the CRD IV on the bank financing of the economy. The results of this work will probably have implications for the strategic approach adopted by the EC for bank regulation. During the reforms to be introduced under the Capital Markets Union Action plan, it is important not to lose sight of the impact on the financial system's stability.

Finally, the international community of supervisory and financial authorities is also taking a critical look at the treatment of sovereign risks or risks associated with exposure to governments. Those exposures currently receive preferential treatment in the calculation of the capital requirements for banks. The Basel Committee and other international groups are examining the extent to which that preferential treatment is still justified in the light of the crisis, and whether a change in that approach would affect related spheres such as the financing of governments and monetary policy.

4.2 Belgian legislation

Owing to the creation of the SSM and the direct supervision by the ECB over significant Belgian credit institutions, developments in Belgian legislation mainly concern matters for which the national supervisory authority or the Member State still retain regulatory competence.

That applies in the first place to the structural reforms in the banking sector, where the national legislation has been developed further in anticipation of a European framework. In this connection, the Banking Law prohibits Belgian credit institutions which collect deposits or issue debt instruments covered by the Belgian deposit protection system from engaging in proprietary trading activities or certain very high-risk trading activities. The Belgian provisions on these structural reforms were set out in detail in the 2014 Report. At the end of March 2015, following consultation with the sector, the Bank published a Circular containing instructions on a periodic qualitative and quantitative reporting obligation, designed to permit regular monitoring of compliance with the provisions concerned. Thus, all institutions have to submit an annual qualitative conformity report. As for the quantitative reporting obligations, the Bank was pragmatic in its allowance for the principle of proportionality. Thus, institutions with a small trading portfolio are exempt from these obligations.

Apart from the structural reforms in the banking sector, the EU Member States also retained some latitude on entry into force of new liquidity standards for credit institutions, namely the LCR and the NSFR. Basel III in fact set two liquidity standards: the liquidity coverage requirement (LCR) and a minimum net stable funding ratio (NSFR). New legislation was needed for these instruments to be used. The LCR was developed in a Delegated Regulation [1], which came into force on 1 October 2015. The NSFR Regulation has yet to be developed. The CRR and the Delegated Regulation provide for a transitional period from 1 October 2015 to 1 January 2018, during which the LCR will be phased in, rising from 60 % to ultimately 100 %. The Member States may nevertheless decide to introduce the 100 % LCR immediately and to

(1) Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No. 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions, *Official Journal* L 11 of 17 January 2015, p. 34.

apply the national rules on liquidity up to 2018. This avoids any temporary weakening of the liquidity requirements in Member States which already have national rules on the subject. Belgium was one of the Member States which already had such rules.

The Banking, Finance and Insurance Commission (CBFA) – and later the Bank – have in fact had a liquidity stress test ratio in place since 2010, measured over a one-month horizon [1]. The Bank decided to replace the existing Belgian liquidity standards with the LCR from October 2015, but to introduce the 100 % LCR immediately, on grounds of prudence. This new liquidity regime was set out in an NBB Regulation [2] and an NBB Circular [3]. The Regulation stipulates that every Belgian credit institution must apply the 100 % LCR at company and consolidated level, and at sub-consolidated level if it is the subsidiary of a European banking group. The Regulation excludes the option of applying certain preferential treatment to incoming and outgoing flows. In principle, the Regulation and the Circular will be abolished once the 100 % LCR is introduced throughout the European Union ; that is scheduled for 1 January 2018. In connection with the development of a harmonised European regulatory framework (see sub-section 3.3.2 of this chapter), the Bank nevertheless decided to repeal these provisions by no later than 1 January 2017.

A third area in which the Belgian legislation is being developed in anticipation of (and in accordance with) future international developments expected in both the Basel Committee and the SSM is the monitoring of the interest rate risk associated with banking activities outside the trading book. In view of the current low interest rates and the potential consequences of both a persistence of these low rates and a possible interest rate turnaround, the interest rate risk has been considered a priority, in recent years, in the supervision of Belgian credit institutions. In this connection, particular attention focused not only on a more refined analysis of recent developments in banks' interest income, but also on an improvement in the prudential reporting of the interest rate risk. At international level, too, work is in progress to strengthen the prudential reporting and treatment of the interest rate risk associated with activities outside the trading book, and to improve the comparability of these procedures. Thus, in May 2015, the EBA published new guidelines on the treatment of the interest rate risk, while the Basel Committee is currently working on a new improved approach to that risk. Finally, the SSM is also in the process of developing its interest rate risk approach.

The prudential reporting and treatment of the interest rate risk of Belgian credit institutions as applied up to the end of 2015 were described in the 2006 Circular on sound management practice in relation to the interest rate risk inherent in non-trading activities [4]. However, analyses revealed substantial differences between the various Belgian credit institutions in regard to the underlying assumptions and methodologies used in that prudential reporting. Since it will be some time yet before the work at international level is completed, an improvement in the quality and comparability of Belgian prudential reporting is an immediate priority. That is why a new Circular [5] will enter into force on 1 January 2016, setting out guidelines on sound management practice and reporting of the interest rate risk associated with non-trading activities. The new Circular contains a number of clarifications and details relating to the underlying methodologies and assumptions to be used in prudential reporting. It also incorporates the said EBA guidelines in the Belgian prudential framework.

The new Circular does not affect the principle that the interest rate risk associated with activities outside the trading book is a risk that needs to be properly managed, assessed and covered by capital within the institution. Prudential reporting aims to compare the risk between different institutions so as to detect any outlier values. The banks are thus expected to manage their interest rate risk positions on the basis of various possible interest rate scenarios, including persistently low interest rates, and in so doing to measure the impact on both the bank's income and on the economic value. Prudential reporting therefore remains a basis on which the supervisory authority assesses the interest rate risk in its SREP and determines any pillar 2 capital add-ons. In its assessment of the interest rate risk according to the principles and reporting described in the Bank's Circular, the supervisory authority considers both qualitative elements (adequacy of the institution's risk management) and quantitative elements (size of the interest rate risk that the institution actually incurs).

4.3 Reporting and accounting

The quantitative and qualitative information that the credit institutions report periodically to the competent authorities is a vital tool for the exercise of prudential supervision. Similarly, the reports that credit institutions publish each year under the Basel pillar 3 framework are an important source of information for market

(1) CBFA Regulation of 27 July 2010 on the liquidity of credit institutions, financial holding companies, settlement institutions and entities equivalent to settlement institutions (repealed).
(2) Royal Decree of 5 July 2015 approving the National Bank of Belgium Regulation of 2 June 2015 on the liquidity of credit institutions, *Moniteur belge / Belgisch Staatsblad* 10 July 2015.
(3) Circular NBB_2015_20 of 2 June 2015.
(4) Circular PPB-2006-17-CPB of 20 December 2006.
(5) Circular NBB_2015_24 of 3 September 2015.

participants wishing to assess the risks that the institution incurs and how it manages them. In particular, the Bank has monitored some recent changes in these respects. On the one hand, this concerns the international accounting rules, and more particularly the European debate on the adoption of the new International Financial Reporting Standard 9 (IFRS 9 – Financial Instruments) destined to replace International Accounting Standard 39 (IAS 39 – Financial Instruments : Recognition and Measurement) from 2018. Also, in 2014, the ECB adopted a new Regulation extending the financial reporting requirements on the basis of the Financial Reporting Framework, known as FINREP. Finally, the Bank transposed into the Belgian legislative framework the EBA guidelines on disclosures under pillar 3, and the 2013 accounting guidelines concerning institutions subject to its supervision.

4.3.1 IFRS 9, Financial Instruments

This new standard, destined to replace IAS 39, is applicable to the banking and insurance sector and was developed in three stages, starting in 2008. The first stage concerned the classification and valuation of financial instruments in IFRS financial statements. The second stage concerned the recognition of losses incurred on those same financial instruments in the event of deterioration in their credit quality (impairment). The third stage was devoted to the accounting treatment of specific hedging operations (micro-hedge accounting). The International Accounting Standards Board (IASB) continues to work on the fourth stage relating to the accounting treatment of hedging operations, particularly interest rate risk hedging, on a broader basis (macro-hedge accounting).

The standard was completed by the IASB in July 2014 and its application will be compulsory from 2018 (it may be applied before that). In Europe, however, its application depends on a decision that the EC is to take following a procedure for the adoption of the IFRS standards. The discussions on this subject are still in progress at European level, notably with a view to resolving the problems specific to the insurance sector.

The Bank kept a close eye on the development of IFRS 9, which aimed primarily to remedy the "too little, too late" effect of the model used in IAS 39 which was based on losses incurred, and hence to improve the quality of the institutions' financial reporting. The main effect of this new accounting standard should in fact be to increase the credit risk provisions by switching to a model based on expected losses, which is more in line with the prudential requirements.

In the discussions on the adoption of IFRS 9 by the European Union, the European bank supervision authorities – via the EBA – stressed the need to give the sector sufficient time to make sound arrangements for the practical implementation of this particularly demanding project.

In that connection, the bank supervisors emphasised that it was crucial for every institution concerned to proceed rapidly with the launch of this project, not only to ensure a qualitative transition within the time allowed, but also to anticipate any repercussions on the capital of the institutions concerned. The competent authorities – together with the EBA – will therefore keep a close watch on the progress of the project in the institutions subject to their supervision throughout the preparatory phase.

Finally, the Bank played an active part in the work of the Basel Committee and the EBA on the drafting of guidelines by the bank supervisory authorities in order to ensure a robust implementation of the new model for recording expected losses in the accounts on the basis of IFRS 9.

4.3.2 Application of FINREP at individual level

FINREP is the European framework defining the financial information that credit institutions must report periodically to the competent authorities. FINREP has applied in Belgium since 2006. Following CRD IV, FINREP was considerably revised and harmonised at European level via an implementing technical standard (ITS) prepared by the EBA, and now applies throughout the EU countries. FINREP was designed mainly to collect IFRS accounting data. It may also be supplemented by accounting data produced according to national standards, but in that case it is necessary to carry out a concordance exercise (mapping) at national level.

On 17 March 2015, under the SSM, the ECB adopted ECB Regulation (EU) 2015/534 on reporting of supervisory financial information. Since the current European rules only cover the financial reporting (FINREP) of credit institutions subject to prudential supervision which apply the IFRS on a consolidated basis, this new Regulation will now make it possible to require financial information in the FINREP format from a) groups which are subject to prudential supervision and draw up their consolidated annual accounts in accordance with national accounting standards, and (b) on an individual basis from all institutions (whether they prepare their accounts on the basis of national or international accounting rules). In Belgium's case, this ECB Regulation only has the effect of imposing FINREP (or part of it) at individual company level (see (b) above), as all

Belgian groups subject to prudential supervision already draw up FINREP on a consolidated basis, using the IFRS.

In order to ease the reporting burden for small institutions, the ECB Regulation makes provision for four sets of more or less binding FINREP tables in order to adapt the content of the data to the characteristics of each group of credit institutions. The Regulation also sets an initial reference date for that reporting, which varies according to the characteristics of each institution. For significant institutions, the first reference date – depending on the institution's characteristics – will be 31 December 2015 ("stand-alone" significant institutions – none as yet recorded in Belgium), 30 June 2016 (other significant institutions), or 30 June 2017 (less significant institutions).

The new ECB Regulation contains no specific provision on the underlying accounting law which must be applied, which means that FINREP needs to be supplemented by data on the credit institution drawn up in accordance with the accounting (or reporting) rules in force in the country concerned. In Belgium, the accounting reference system determined by the 1992 Royal Decrees (BE GAAP)[1] applies to the preparation of the individual company accounts, whereas IFRS applies only to the preparation of consolidated accounts. The main problem in implementing the ECB Regulation will therefore be to establish a concordance (mapping) between FINREP (typically aligned with the IFRS) and the national reporting scheme based on the BE GAAP standards.

4.3.3 Transposition of the Directive on annual financial statements and related reports

In 2015, the Bank presented to the competent ministers a draft Royal Decree transposing the new European Directive 2013/34/EU of 25 June 2013 on annual financial statements into the Belgian accounting law applicable to financial holding undertakings and insurers.

This new Company Law Directive, which repeals and replaces the 4th and 7th Directives on annual accounts and consolidated annual accounts, aims primarily to reduce the administrative burden on small and medium-sized enterprises. However, the administrative simplifications introduced here do not apply to financial holding undertakings and insurers, which are regarded as public-interest entities in the same way as listed companies. Owing to their public importance, these undertakings are required to meet more extensive financial reporting requirements at all times. The new Directive also introduces a range of new reporting requirements. For instance, in the notes to the financial statements, financial holding undertakings and insurers have to supply information on important events which occurred after the balance sheet date.

4.3.4 Application of the EBA guidelines to pillar 3

Part VIII of the CRR (Articles 431 *et seq.*) defines the public disclosure obligations, also known as pillar 3 requirements, applicable to credit institutions and investment firms. That information is meant to enable market participants to measure the level of risk facing each institution and thus to exercise some form of market discipline over it. Article 432 of the CRR states that institutions need not publish the required information if it is considered non-material, proprietary or confidential. Article 433 of the CRR also stipulates that institutions must publish the required disclosures at least once a year, but must assess the need to publish some or all of them more frequently in the light of the specific characteristics of their activities.

In December 2014, on the basis of the powers conferred on it by these provisions, the EBA published guidelines on (a) the way in which institutions must apply the concept of material, proprietary or confidential information in relation to the pillar 3 requirements, and (b) the assessment by the institutions concerning more frequent disclosure of that information.

In 2015, in order to incorporate these EBA guidelines in the national framework, the Bank issued a Circular to Belgian credit institutions and stock-broking firms, requesting them to conform to the EBA guidelines.

4.4 Developments concerning governance

4.4.1 reparation of a governance handbook for the banking sector

Following the international developments relating to governance, both at the level of the supervisory authorities (new directives issued by the Basel Committee and the EBA) and in European legislation, the Banking Law updated the various rules on governance and specified them in more detail in 2014.

The cross-sectoral Circular dated 30 March 2007[2] has in fact become largely obsolete. In those circumstances,

(1) Royal Decree of 23 September 1992 on the annual accounts of credit institutions, investment firms and UCI management companies.
(2) Circular NBB_2015_25: Guidelines on the disclosure of information (pillar 3, CRD IV).

during the year under review the Bank developed a governance handbook which replaces that Circular, at least where credit institutions are concerned[1].

The handbook aims to bring together all the legal documents relating to governance (Banking Law, explanatory memorandum, Regulations, Circulars, European legislation, and international standards) applicable to credit institutions and to provide additional clarification where necessary. The handbook also discusses subjects which are not actually covered by specific legal documents.

The main innovation consists in the possibility of consulting the handbook on line (see www.nbb.be/governancebanks), which enables institutions to look through all the legal documents in a very user-friendly way using interactive links. The aim is for the handbook to become a "dynamic" tool, without the need for systematic adjustment of the references and names which it contains, as in the case of the circulars, for example. Any changes will always be notified to the institutions.

4.4.2 Remuneration policy

In 2015, the Bank conducted another detailed horizontal analysis of large institutions' compliance with the remuneration policy rules – this time in close consultation and collaboration with the SSM. By using the same method to compare institutions with one another, the Bank aims to promote a level playing field in the Belgian financial sector. In this case, six large institutions had been included in the analysis which related to 2014 performance for which variable remuneration had been paid at the beginning of 2015. The Bank paid particular attention here to the new points introduced by the CRD IV and to the implementation of the recommendations which it had made in the previous year.

The primary point highlighted by this fifth horizontal analysis is the importance of proper documentation of the process of selecting the Identified Staff, including staff identified purely on the basis of the level of their remuneration but not ultimately selected because their professional activities were not considered to have any material influence on the institution's risk profile. This should enable the Bank to verify that the selection process conforms to the rules. The Bank also asks for the documentation to include a comparison with the results of the previous year's selection process.

Next, the Bank finds that, in general, there has been a shift from variable to fixed remuneration following the introduction of the cap on variable remuneration. Insofar as role-based allowances are used for that purpose, the Bank stresses that it is necessary to respect the conditions whereby remuneration can be considered fixed, as laid down in the EBA Opinion of 15 October 2014 on the use of allowances.

Third, the Bank notes increased transparency concerning the link between risks and remuneration policy. That applies both to the actual remuneration policy and to its translation into specific decision-making. Moreover, efforts have been made to vary the percentages of deferred variable remuneration according to differences between staff. That said, the payment is generally only deferred for the statutory minimum of three years. However, the Bank expects significant credit institutions as defined in Article 3, 30°, of the Banking Law to apply a minimum delay of five years, at least in the case of members of the board of directors and the people effectively managing the institution.

Finally, each institution must examine how it can conform to the legal requirement whereby at least 50 % of any variable remuneration consists of an appropriate balance between shares or equivalent instruments and, if possible, other capital instruments mentioned in the Banking law[2]. The conditions governing the use of those capital instruments as variable remuneration are listed in the technical regulatory standards adopted by the European Commission[3]. Those instruments can only be used if they have been issued and are sufficiently available. The institutions are asked to examine whether they can use that type of instrument and to inform the supervisory authority accordingly.

At European level, the EBA published a report on 7 September 2015 entitled "Benchmarking of remuneration practices at Union level and data on high earners", relating to the 2013 performance year. That report is based on remuneration data from a representative sample of institutions, collected by national supervisory authorities, including the Bank. The document reports a further fall in the ratio between variable and fixed remuneration. It also identifies a number of other trends at EU level, including in regard to the number of Identified Staff and the composition of the remuneration.

The EBA Guidelines on Remuneration Policies and Practices were also updated to take account of the

(1) Circular NBB_2015_29: Introduction of a governance manual for the banking sector.
(2) This concerns more specifically capital instruments which meet the conditions for eligibility as additional Tier 1 or Tier 2 capital instruments, or other instruments which can be fully converted into Tier 1 core capital instruments, or which can be fully written down, and which in any case accurately reflect the credit quality of the institution from the point of view of continuity.
(3) Delegated Regulation (EU) No. 527/2014 of the Commission of 12 March 2014.

experience gained since they were first applied in 2011 and the changes made in the wake of the CRD IV. These guidelines set out in detail the requirements concerning a good remuneration policy. The points addressed include the following: governance requirements, the application of remuneration policy in a group context, the process of selecting Identified Staff, the distinction between fixed and variable remuneration with a view to the correct calculation of the ratio between these two components, the requirements concerning the link between risks and remuneration policy, etc. The EBA guidelines also make a distinction between obligations applicable to all staff and those applying only to the Identified Staff. The Bank will be guided by this EBA reference document in the actual exercise of its supervision over remuneration policies and practices.

D. Insurance

In this chapter, the "Solvency II" Law means the Law transposing into Belgian law the European Solvency II Directive as amended by the Omnibus II Directive. For simplicity, the term "Solvency II Law" is used even though, when this Report went to press, it was still a draft Law which has yet to be debated in Parliament. It is therefore possible that some of the provisions mentioned in this Report may yet be amended, especially as the implementing Decrees were still at the draft stage.

1. Introduction

The introduction of the new regulatory framework for insurers and reinsurers (Solvency II) on 1 January 2016 presents a major challenge for both the sector and the supervisory authority. The risk-based approach adopted in Solvency II could have a significant impact on the business model of insurance companies. For instance, additional capital could be stipulated in order to meet the new capital requirements. Another point for attention concerns the development and implementation of the processes and procedures necessary to meet the Solvency II requirements. The supervisory authority will also have to revise its practices to incorporate the risk-based approach in its routine supervision and to make full use of the new reporting.

The entry into force of Solvency II marks the end of a long legislative process. In 2014, a final agreement was reached on the revision of the Solvency II Directive [1] (by the Omnibus II Directive [2]), opening the way to the development of the Delegated Regulation by the European Commission and technical implementing standards and guidelines by the European Insurance and Occupational Pensions Authority (EIOPA). In 2015, the Solvency II Directive, as amended by the Omnibus II Directive, was transposed into Belgian law (the Solvency II Law). Following a "comply or explain" procedure, the great majority of the EIOPA guidelines were endorsed by the Bank before being transposed into circulars or internal procedures.

The preparatory work relating to Solvency II also led to thorough revision of the existing regulatory framework for the prudential supervision of insurers and reinsurers. The Royal Decree on the annual accounts of insurers and reinsurers refers to the provisions of Solvency I for the calculation of the technical reserves. As the Solvency I framework is being dropped, these provisions are incorporated in the Royal Decree itself. New provisions on the formation of an additional life insurance reserve (the flashing-light reserve) are also being introduced. The Royal Decree on life insurance activity was also aligned with the provisions of the Solvency II Law, and some sections on consumer protection were taken out. A new Royal Decree on profit-sharing has been drafted, which takes account of both the profitability and the solvency of the institution and gives the Bank the power to limit profit distribution in specific cases.

In view of the large volume of new regulations entering into force in 2016, both the insurance sector and the Bank face a considerable operational risk. Will all institutions meet the new legal requirements? Have adequate procedures been set up? Will the institutions be able to deliver qualitative and quantitative reporting? And will the quality of those reports be satisfactory? The first reports submitted

(1) Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency I Solvency II).

(2) Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No. 1060/2009, (EU) No. 1094/2010 and (EU) No. 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority).

during the preparatory phase showed that many institutions still needed to make considerable progress.

Section 2 of this chapter begins with an overview of the insurance institutions and groups operating in Belgium. Section 3 discusses the sector's qualitative and quantitative preparations for Solvency II. Section 4 deals with the monitoring of some priority risks and concludes with an account of the Bank's main regulatory initiatives.

2. Mapping of the sector

2.1 Insurers

At the end of 2015, the Bank exercised supervision over 91 insurers, reinsurers, surety companies and regional public transport companies which insure their fleet of vehicles themselves. The number of supervised undertakings has been falling slowly but steadily since the end of 2012, when the figure was still 113. This decline is due mainly to mergers and the cessation of business following the transfer of portfolios (about three-quarters of the decline). The expiry of insurance liabilities and the conversion of Belgian companies into branches of insurance companies of other EEA member countries account for about one-quarter of the reduction.

2.2 Insurance groups

At the end of 2015, 17 Belgian insurance groups were subject to the Bank's supervision. Eight of them only have holdings in Belgian insurance undertakings (national groups), while the other nine have holdings in at least one foreign insurance undertaking (international groups). Under Solvency II, the Bank is the group supervisory authority for each of those groups and, in that capacity, it receives specific reports which form the basis of prudential supervision at group level.

In order to facilitate group supervision, the supervisory authorities of cross-border groups work together in colleges of supervisors. These colleges ensure that the collaboration, exchange of information and mutual consultation between the supervisory authorities of the EEA member countries actually takes place in order to promote the convergence of supervisory decisions and activities. The establishment and operation of the colleges are based on coordination arrangements between the supervisory authorities concerned.

TABLE 4 NUMBER OF UNDERTAKINGS SUBJECT TO SUPERVISION [1]

	2012	2013	2014	2015
Active insurance undertakings	87	83	80	75
Insurance undertakings in run-off	9	8	4	3
Reinsurance undertakings	1	1	1	1
Other [2]	16	14	12	12
Total	**113**	**106**	**97**	**91**

Source: NBB.
(1) In addition, at the end of 2015, the Bank also exercised prudential supervision over ten branches of companies governed by the law of another EEA member country, although that was confined to checking compliance with the money-laundering regulations.
(2)) Surety companies and regional public transport companies.

TABLE 5 BELGIAN INSURANCE GROUPS SUBJECT TO THE BANK'S SUPERVISION

Belgian national groups	Belgian international groups
Alleasehold	Ageas SA/NV
AMMA Assurances	Argenta Assurances
Cigna Elmwood Holdings	Aviabel
Credimo Holding	Belfius Assurances
Fédérale Assurance	Credimundi
Fork Capital	Integrale
Securex	KBC Assurances
Vitrufin	PSH
	Trade Credit Re Insurance Company

Source: NBB.

In 2015, coordination arrangements were agreed for each Belgian international group with the supervisory authorities concerned. Coordination arrangements were also signed for insurance groups which have their head office in another EEA member country and a subsidiary in Belgium.

TABLE 6 COLLEGES FOR INSURANCE UNDERTAKINGS SUBJECT TO THE BANK'S SUPERVISION

The Bank is the group supervisory authority	The Bank is one of the supervisory authorities involved	
Ageas SA/NV	Allianz	Allianz Benelux
Argenta Assurances		Euler Hermes
Aviabel		
Belfius Assurances	AXA	AXA Belgium
Credimundi		Inter Partner Assistance
Integrale		Touring Insurance
KBC Assurances		
PSH	Assurances du Crédit Mutuel	Partners Assurances
Trade Credit Re Insurance Company		
	Delta Lloyd	Delta Lloyd Life
	Generali	Generali Belgium
		Europ Assistance Belgium
	Munich Re	D.A.S.
		Ergo Insurance
		DKV Belgium
	NN	NN Insurance Belgium
		NN Insurance Services Belgium
	Baloise Group [1]	Baloise Belgium
		Euromex

Source: NBB.
(1) The coordination arrangements will be signed during 2016.

3. Preparation for Solvency II

3.1 General framework

2015 was an important year in the preparation for entry into force of Solvency II. In September 2013, the uncertainty surrounding the adoption of the Solvency II Directive in Europe prompted EIOPA to publish guidelines in preparation for Solvency II. At the end of 2013, these guidelines were endorsed by the Bank and transposed into the following Circulars in preparation for Solvency II :

– The Circular on requirements concerning the prospective assessment of own risks ;
– The Circular on requirements for pre-applications for use of an internal model ;
– The Circular on requirements concerning the governance system ;
– The Circular on requirements concerning the communication of information to the Bank.

The undertakings implemented these Circulars in 2014, and the Bank monitored both the implementation and the progress of the preparations for Solvency II in 2015. Similarly, during 2015, after conducting a consultation on the subject, the Bank published a whole series of Circulars intended to help insurers to make the necessary preparations. Two additional Circulars were also published : one concerning the supplementary requirements on the communication of information to the Bank, and the other on the simplification of the Solvency I reporting during the preparatory stage.

3.2 Assessment of the qualitative preparations

The Bank's various contacts with the insurance sector showed that, up to mid-2014, the insurers' preparations focused mainly on the development of internal models and on other more financial and quantitative aspects of the Solvency II requirements. During the year under review, developments concerning the assessment of the solvency needs and governance were also closely monitored.

Pursuant to Solvency II, as an integral part of their business strategy, undertakings must regularly assess their own solvency needs in the light of their specific risk profile (Own Risk and Solvency Assessment, ORSA). In 2014, the Bank used a qualitative assessment model to examine, for a number of companies, the extent to which their internal processes were prepared for that. In 2015, the points for attention which emerged from that examination were monitored and the assessment was updated on the basis of new information obtained from the ORSA reports. During the year under review, the Bank also paid particular attention to the low yield environment. Thus, large insurance companies were also asked to assess their solvency situation in a scenario in which, after 20 years, the risk-free interest rate curve used to value the insurance portfolio does not converge on an interest rate of 4.2 %, but on a lower interest rate in line with market conditions.

Apart from monitoring the progress of the ORSAs, in 2014, the Bank also asked all insurers to test their governance system against the Solvency II requirements and to draw up an action plan to remedy any defects before entry into force of the new regulatory framework. In so doing, the Bank intended to draw insurers' attention to a number of points concerning governance under Solvency II. The results of this questionnaire were analysed in 2014, and in 2015 the findings were relayed to the insurance companies.

In general, it was found that insurers did not face any insurmountable problems preventing them from

complying with the Solvency II governance requirements. Nonetheless, some undertakings were asked to make more effort to ensure that compliance. Their lack of attention to the instructions on requirements relating to expertise and professional integrity was a recurrent failing. Insurers must attach more importance, among other things, to situations which could lead to a reappraisal, and to the procedures for the appraisal of other key staff. In many cases, insurers were also asked to make sure that the actuarial function is allocated sufficient resources so that it can perform its duties in an appropriate, totally independent way. Furthermore, the actuarial function must also be properly organised at group level. Another point for attention is the need to designate someone within the undertaking to take on full responsibility for key functions which are outsourced.

3.3 Assessment of the quantitative preparations

The Bank expects insurers and insurance groups to develop appropriate systems and procedures to supply high-quality information for the purposes of prudential supervision. The information submitted in that respect during the preparatory stage enables the Bank to examine and assess the progress made and the quality of the information provided.

The Bank decided that all Belgian insurers and insurance groups must submit annual and quarterly Quantitative Reporting Templates (QRTs) for 2014 and for the third quarter of 2015. However, in the case of small undertakings and small groups, the Bank limited the scale of the reporting. The final version of the reporting templates will form the basis of the Bank's periodic risk analyses and will provide a deeper insight into the solvency position and the financial situation under Solvency II. In analysing the QRTs, the Bank was also able to draw on the specific reports compiled by the approved auditors.

3.3.1 Quantitative reporting by insurers

The great majority of undertakings succeeded in submitting their QRT for 2014. For various reasons, six companies did not manage to do so. For instance, some of those undertakings were destined to exit the market before the entry into force of Solvency II, while others are subject to special provisions on account of their small size, so that there was no point in reporting during the preparatory stage. Some companies were in the process of a strategic reorientation during the preparatory stage and therefore did not submit reports. Insurers which did not report or which were very late in doing so were contacted on the subject and are being closely monitored.

At the end of November 2015, the Bank also received the QRTs relating to the third quarter of 2015. These figures indicate an improvement in the operational preparedness of the undertakings since the first wave of QRT reporting. In regard to the QRT reports relating to the third quarter of 2015, 79 % of undertakings fulfilled their obligations within a week of the final deadline, whereas only 50 % had achieved that in the first wave.

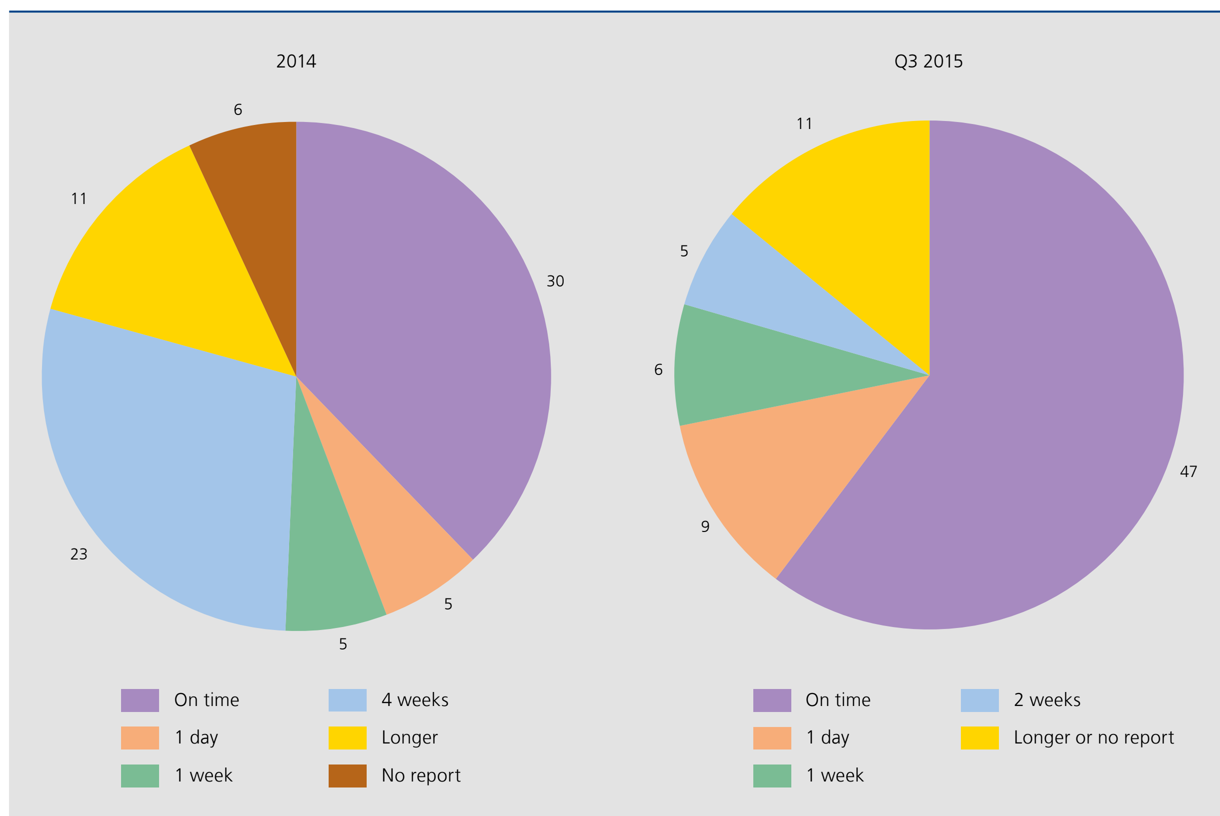
3.3.2 Quantitative reporting by insurance groups

The obligation to submit the annual and quarterly QRTs during the preparatory stage applied equally to all Belgian insurance groups. The deadline for group reporting relating to the 2014 financial year was set at 15 July 2015. Of the 17 insurance groups subject to the obligation, only 11 submitted their reports. One insurance group had planned to absorb its only insurance subsidiary before the entry into force of Solvency II, so that group reporting was irrelevant. Most of the groups that submitted reports did so on time. Only one group was more than a month behind the deadline.

In relative numbers, the insurance group reporting clearly fell short of the figures for insurers. The groups which did not report or which were late in doing so were contacted on the subject and are being closely monitored to check the continuing development of the underlying systems and procedures, as the Bank also expects insurance groups to submit accurate reports on time. At the beginning of 2016, the Bank received the group reports relating to the third quarter of 2015, and on that basis it reassessed the operational preparedness of the groups.

The Bank decided to extend the reporting obligation during the preparatory stage to the market as a whole, and not limit it to insurance undertakings and groups covered by the EIOPA guidelines on the submission of information to the competent national authorities. Taking account of that and in view of the scale and operational complexity of the reporting, the Bank is cautiously optimistic about the operational preparedness of Belgian insurers and insurance groups. Undertakings which did not manage to submit their reports or failed to do so on time are expected to do significantly better in future reporting cycles.

CHART 7 QRT REPORTING BY INSURERS
(number of undertakings)



Source : NBB.

3.3.3 Results of the analysis of the content of the quantitative reporting

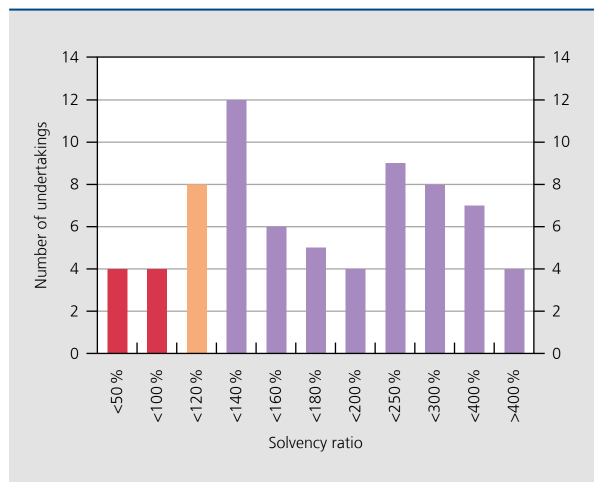
The preparatory stage was originally designed to put the emphasis on the operational aspect of the reporting, rather than on the quality of information supplied. However, the publication of the results of the EIOPA stress test at the end of November 2014 – using data relating to the end of 2013 – and the further deterioration in the macroeconomic environment for insurers since the end of 2013 prompted EIOPA and the national supervisory authorities to conduct a broader and more detailed analysis of the impact of the current economic environment and the degree to which the sector is prepared for Solvency II. The QRTs formed a key element of that analysis.

The Bank found that the quality of the data submitted during the preparatory stage was inadequate, and is continuing to monitor that aspect, in collaboration with the undertakings concerned. Overall, the quality of the reporting needs to improve considerably if it is to satisfy the legal requirements of Solvency II and be usable for prudential purposes.

The Bank launched a dialogue with insurers reporting a solvency ratio below the statutory minimum (100 %) during the preparatory stage. It reviewed the measures that those undertakings could adopt to restore their solvency position before the actual entry into force of Solvency II. Various types of prudential measures were taken, such as the option of using – subject to the Bank's approval – certain transitional provisions or certain parameters specific to the undertaking concerned, adjustment of the reinsurance structure, a reduction in the guaranteed interest rates, de-risking of the asset portfolio or an increase in the capital. In view of the poor quality of the information, that approach was also extended to all undertakings with a solvency ratio of less than 120 % or those confronted since the reporting by new events liable to jeopardise the solvency ratio.

The approach aimed mainly to set up an action plan for these undertakings which, if successfully implemented, would enable them to achieve sufficient solvency by the time the new rules took effect. Despite this proactive approach, it is still possible that some undertakings may still be insufficiently solvent, e.g. because the planned

CHART 8 SOLVENCY RATIOS REPORTED FOR THE YEAR 2014



Source: NBB.

measures have not yet been fully implemented or because a change in the macroeconomic circumstances has had a serious adverse effect on the solvency ratio.

Examination of the solvency ratios reported during the preparatory stage for 2014 reveals that the ratio is below 100 % for 8 undertakings. Another 8 undertakings reported a solvency ratio of between 100 % and 120 %. Although serious solvency deficits were identified for several individual undertakings, the deficit at market level is small. The solvency deficit for these 8 undertakings corresponds to 1.6 % of the solvency capital requirement for the market. The market solvency ratio stands at 190 %.

In October of the year under review, EIOPA presented a summary report on the monitoring of undertakings with a solvency deficit and the measures taken to address it, and on the impact of the current market conditions on their present and future solvency situation.

3.4 Specific points for the Bank's attention

3.4.1 Internal models

In 2015, the Bank analysed the applications from insurers wishing to use an internal model to calculate their regulatory capital under Solvency II.

As a result of the pre-application procedure conducted since 2010, the number of undertakings intending to use an internal model has fallen sharply, as the Bank's inspection reports demonstrated to five undertakings that they would find it difficult to meet the Bank's stipulations for internal models, based on the legal requirements. Those undertakings decided to end their pre-application procedure or postponed the planned date for submitting their application.

Seven applications were expected in 2015. After their latest contacts with the Bank, two undertakings opted to delay the date for submitting an application. One application for a (virtually) full internal model was rejected. That leaves four undertakings (two full internal models and two partial internal models) whose applications were accepted, but only after the imposition of additional capital requirements and conditions. In most cases – depending on the approach adopted by the colleges concerned – those points were inserted in a remedial plan that the undertakings added to their application. There were also two new applications submitted at the end of 2015 on which a decision will be taken in 2016.

In general, a key factor for success seems to consist in the undertakings being aware of the substantial resources needed to develop and validate the internal models, and planning accordingly at a sufficiently early stage. One of the most important points for attention identified by the analysis of the applications was that some subsidiaries of foreign insurance groups have inadequate knowledge of their internal model developed at group level, so that they cannot really take it on board; another important point is that various undertakings underestimated the role of the national supervisory authorities in the process of deciding on the approval of an internal model at group level. In addition, the independent internal validation is often insufficiently critical, so that too few questions are asked about the fundamental choices relating to the models. In regard to types of risk, the modelling of the life underwriting risk has not yet generally achieved the same quality standards as the modelling of other types of risk. Finally, it seems that, in some cases, the weaknesses detected in internal models for the calculation of the solvency capital requirement also have a significant impact on the calculation of the technical provisions under the new prudential rules (best estimate) and/or the solvency capital requirement determined by the standard formula (particularly in the case of life insurance activities).

3.4.2 Assessment of the best estimate

Assessment by the Bank

Last year, the assessment of the adequacy of the technical provisions applicable under the new prudential

rules took up most of the inspection team's resources. That was due partly to the size of the amounts forming the technical provisions on insurers' balance sheets – the best estimate represents the bulk of an insurer's liabilities and plays a crucial role in determining its solvency – and partly to the duration of these liabilities. In particular, this last factor leads to complex actuarial calculations based on a large number of assumptions, parameters and measures envisaged by the insurer's management bodies, and a degree of uncertainty which must be assessed with due caution.

The examinations carried out by the inspection teams led to a significant increase in the total amount of the technical provisions of the insurance companies considered. Furthermore, following various inspections conducted in 2015 on the calculation of the technical provisions, the Bank has identified several points to which it will pay particular attention during implementation of Solvency II to determine whether the undertakings have made the correct adjustments.

First, there was evidently a great disparity between life and non-life insurance activities, the latter generally presenting fewer problems owing to the relatively short duration of the liabilities and good overall control of the claims management process. The second point for attention is the often incorrect application of the prudential rules on contractual limits, concerning whether or not the results of future business are taken into account in the calculation of the technical provisions. It was also found that the financial projections do not take accurate account of the costs associated with insurance liabilities, and that the risk margin – i.e. the margin to be applied as a prudence factor in addition to the calculated best estimate – is not correctly estimated. The application of discounting curves other than the one published by EIOPA also gives rise to problems. The final point for attention is the inadequate estimate of future profit-sharing in view of the expected yields from the assets representing the technical provisions.

Development of the assessment instrument

In connection with checking the best estimate, the Bank has developed a special form of reporting on life insurance operations. For that purpose, insurers have to report all cash flows involved in determining the best estimate. Other data must also be reported, namely the cash flows used to rebuild the inventory reserves for the insurance policies concerned, and various general statistics relating to parameters such as average age, sums insured, average guaranteed interest rates, etc. The figures reported by the insurer will be processed in various ways to permit a breakdown of the best estimate into its constituent parts, a reconciliation of the best estimate with the inventory reserves, and a range of consistency tests.

The data reported by the undertakings will also be used to map the insurance portfolios on the basis of the said general statistics. These various points can then be examined to arrive at an initial assessment of the suitability and conformity of the best estimate calculation. The conclusions of that initial analysis will then be used to consider whether that best estimate – or some elements of it – should be examined in more detail.

In the year under review, these data were collected for the first time from 7 large Belgian insurers. In the case of those companies, the full report as at 31 December 2014 was expected by the end of 2015 at the latest.

Assessment by external experts

In connection with the measures in preparation for Solvency II, it was vital for the Bank to have sufficient confidence in the calculation of the best estimate by the undertakings. As well as carrying out its own inspections, the Bank also called in external actuarial experts to assess the quality and suitability of the best estimate of the seven largest Belgian insurers.

In their report, the external experts gave their opinion on such matters as the accuracy of the amount of the best estimate and on the correct use of the data, assumptions and models. Where possible, they also quantified the impact of the shortcomings identified. During June 2015, the provisional findings were presented to the management of the insurance undertakings concerned and to the Bank, after which the reports were finalised.

The analysis of these reports resulted in a number of findings for each undertaking. Those findings were notified to the individual undertakings with a request that they draw up an action plan, on the basis of which the Bank will be able to monitor their progress. Comparison of the individual findings revealed a number of divergent market practices and points for attention, which will be considered in greater depth via horizontal analyses in order to foster greater convergence and harmonisation.

The work of the external experts is regarded as a useful supervision instrument during the preparations for

Solvency II. It enabled the Bank to meet a specific need without entailing any structural increase in operating costs. This type of assignment will not be repeated in the immediate future, although the use of external experts remains an option which might be considered under specific circumstances.

4. Priority risks

4.1 Interest rate risk

The potential consequences of persistently low interest rates are the biggest financial risk facing insurers, and therefore remain a point for the Bank's attention. In view of the fragile macroeconomic situation, the boost provided by the interest rate rise since April 2015 could be shortlived. Moreover, the Belgian insurance sector still features high guaranteed yields on certain life insurance products.

In 2014, the Bank developed a new standard report to permit more detailed monitoring of the interest rate risk facing all insurers. That report consists of various components which are important for providing an accurate and complete picture of the interest rate risk situation in insurance undertakings. This concerns more particularly the following four aspects: the composition of the current outstanding guaranteed yields on insurance portfolio contracts, the duration of the technical provisions and their covering assets, detailed projections for cash flows from the technical provisions and their covering assets, and projections relating to yields on the assets and liabilities.

The results of the first round of reporting, based on the figures at year-end 2013, were submitted to the Bank at the end of the third quarter of 2014 and were still being analysed in 2015. On the basis of those data, the Bank developed a series of indicators providing a better insight into the interest rate risk facing both individual insurance companies and the market. Points considered include the level of the average guaranteed yields and their residual term, the proportion of the technical provisions with interest rate guarantees on future premiums, the various duration gaps and the matching of the underlying asset and liability cash flows.

On the basis of this assessment framework, undertakings can be given a score for each of these indicators and in some cases outliers can be identified. The undertakings concerned are subjected to more detailed examination, which may result in a request for an action plan or the imposition of mitigating measures, such as the purchase of derivatives.

The Bank found that some undertakings failed to submit these reports, and that the data quality was not always up to expectations. Thus, data from some undertakings were excluded from the dataset following an in-depth assessment. The comments submitted to the insurance companies during this first reporting cycle should ensure that the quality improves significantly in the years ahead. In addition, on the basis of the aforesaid analyses, the Bank also examined whether it was appropriate to impose risk mitigation measures on some of these undertakings.

4.2 Liquidity risk

Since 2011, the Bank has taken various initiatives to chart the liquidity risk facing the insurance sector in Belgium. For that purpose, a section on liquidity was first added to a more general report which aimed to reveal the vulnerabilities of the six largest Belgian insurance groups.

The figures reported showed that a number of Belgian insurers faced rising redemptions and falling premium income. The main factors here are a change in the tax treatment of life insurance products, as the tax on premiums was increased from 1.1 % to 2 % in 2013, the current low interest rates, and the fact that an ever-growing proportion of the class 21 portfolio is now eight years old, bringing exemption from the withholding tax for certain contracts (e.g. on redemption). Moreover, increasing numbers of insurers are deliberately turning away from offering certain class 21 products.

At the end of 2014, the Bank decided, on the basis of these initial results, to introduce separate quarterly liquidity reporting for all life insurance undertakings. Also, to permit integrated monitoring of the liquidity risk, the Bank developed a series of risk indicators. These can be divided into three groups. The first group of indicators focuses on the trend in incoming and outgoing cash flows and how they are interconnected. The second group examines the trend in liquid assets and liabilities and the ratio between them. The third group of indicators monitors the trend in exposures to instruments and derivatives presenting a potential liquidity risk. Each group of indicators is then linked to a range of risk limits so that the risk can be monitored systematically for each indicator.

On the basis of the initial results for the life insurance sector as a whole in Belgium, it emerged that, during the first half of 2015, around 48 % of Belgian life insurers had to contend with an outflow from the traditional life insurance portfolio that exceeded premium income for at least one of the two quarters. In the case of around 16 % of the undertakings, the total outgoing cash flow came to more than twice the premium income. If redemptions alone are considered, it can be said that for 16 % of undertakings (not necessarily the same ones as those mentioned above), the related cash flows exceeded their premium income. These are often undertakings which are actively trying to scale down their life insurance portfolio (or part of it). There has also been a downward trend in the proportion of the assets that can be considered liquid. It declined from around 61 % at the end of 2014 to 55 % as at 30 June 2015. Moreover, there are very marked differences between undertakings in the ratio of liquid assets to liabilities which could, in theory, be cancelled without (any major) penalty. For most undertakings the volume of the liquid assets is still more than sufficient to cover the most liquid liabilities. Finally, a small number of undertakings (13.5 %) hold, at face value, a quantity of derivatives accounting for more than 10 % of the total market value of their investment. A similar conclusion can be drawn for the same percentage of undertakings (not necessarily the same ones) in regard to their exposure to repo transactions, securities lending and other related activities.

The results of the liquidity reporting described above led to follow-up measures for a small group of undertakings. The Bank also decided to maintain the liquidity reporting under Solvency II.

5. Legislation

The introduction of a new regulatory framework for the prudential supervision of insurers and reinsurers led to the preparation of the Solvency II Law and a large number of implementing measures and Circulars. The abolition of the Solvency I framework and disappearance of the Law of 9 July 1975 provided an occasion for a thorough review of all the existing rules on the prudential supervision of insurers and reinsurers. Some Royal Decrees and Circulars have already been recast on account of Solvency II, but owing to the large volume of legislation that exercise will continue in 2016. As explained in Box 3, the disappearance of the medical index and the rising health care costs meant that particular attention must be paid to requests for an increase in health insurance tariffs.

5.1 The Solvency II Law

The Solvency II Law on the legal status and supervision of insurance and reinsurance undertakings transposes the Solvency II Directive. This Law replaces those governing the supervision of insurance undertakings (Law of 9 July 1975) and reinsurance undertakings (Law of 16 February 2009), and their implementing Decrees will also be rewritten.

The Solvency II Law represents a significant reform of the prudential supervision of insurers and reinsurers, focusing that supervision on the knowledge, control and attenuation of all types of risk associated with the pursuit of their activities. The approach is prospective, covering all elements of the balance sheet in assessing the real risks. For that purpose, the asset and liability items are stated at their market value. Like the Solvency II Directive, the Law is based on three pillars. The first pillar determines the quantitative requirements relating to capital and technical provisions, the second lays down qualitative rules on the monitoring of the risks by the undertakings, and the third determines the information that the undertakings must supply, either for supervision purposes or for the public. A number of points specific to Belgium merit particular attention.

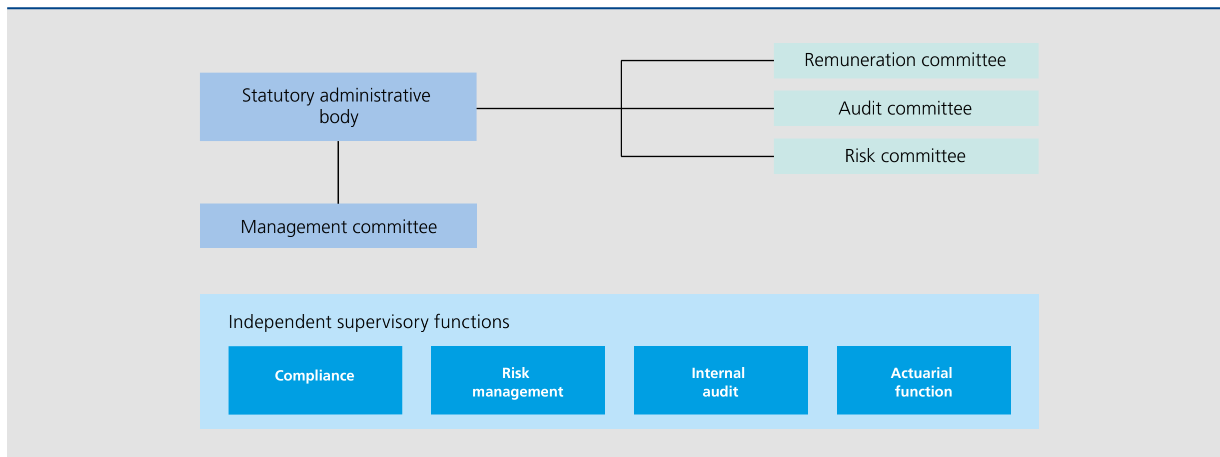
5.1.1 Governance

The Solvency II Directive leaves the national legislatures some latitude to supplement and specify the requirements to be met by insurers and reinsurers. The Solvency II Law used that option to establish a governance system which is based on the minimum requirements of the Directive but also takes account of the achievements of earlier legislation and equal treatment with the other financial sectors.

The governance structure of an insurer or reinsurer comprises a statutory administrative body, usually the board of directors, which carries ultimate responsibility for the undertaking and is in charge of the strategy and determination of the risk policy, a management committee which holds all the powers to manage the undertaking, three specialist committees within the board of directors (remuneration, audit and risk committee), and four independent supervisory functions or key functions (compliance, internal audit, risk management and actuarial function).

Taking account of the relative heterogeneity of the sector, the Solvency II Law provides for various exemptions from this standard structure to allow for the undertaking's specific situation. Thus, as regards the management committee, the new Law incorporates the principles included in insurance supervision law since 2014. In principle, it is obligatory to establish this committee but – depending on the undertaking's size and risk profile – the Bank may grant exemption *inter alia* in respect of the obligation to set up such a committee, its composition or the

CHART 9 GOVERNANCE STRUCTURE



Source: NBB.

prohibition on combining the chairmanship of the management committee with that of the statutory administrative body.

The new Law no longer requires the management committee to be composed entirely of members of the statutory administrative body, but stipulates only that three members of that committee – or even two if the risk management officer is not a member (see below) – must also be members of the statutory administrative body. Conversely, it maintains the obligation whereby non-executive members of the statutory administrative body must make up the majority of that committee.

In regard to the specialist committees, the Solvency II Law provides for two exemptions which do not require the approval of the supervisory authority. The first means that specialist committees are not obligatory in undertakings which meet at least two of the following criteria: average number of employees below 250 people, balance sheet total of € 43 million or less, and annual net turnover of € 50 million or less. In that case, the functions of the committees are performed by the statutory administrative body as a whole. Under the second exemption, in undertakings with a balance sheet total of less than € 3 billion, a single body may exercise the powers of the audit committee and the risk committee.

Two other exemptions are subject to the Bank's prior approval. The first waives the obligation to establish one or more of the three specialist committees if the insurer or reinsurer is part of a group and if such a committee has been set up in an undertaking controlled by the group (e.g. in a credit institution or insurance holding company). Obviously, the committee set up at group level must have powers which extend to the insurer or reinsurer. The second exemption only concerns the remuneration committee. That committee need not be formed if the company is organised in such a way that the statutory administrative body receives adequate support.

There is also provision for some flexibility in regard to the risk management function. In principle, a member of the management committee is in charge of that function. However, the same person may combine that post with responsibility for the compliance function and the duties of the actuarial function which do not generate risks (e.g. the preparation of certain reports), provided the actual performance of the three functions is kept separate and there are no conflicts of interest. In the case of undertakings with a balance sheet total of € 3 billion or less, there is no need to obtain the consent of the supervisory authorities in this respect.

The Bank may also allow the risk management function to be headed by someone who is not a member of the management committee if the undertaking's risk profile so permits and if there is no conflict of interests concerning that officer.

In comparison with other financial sectors, especially the credit institution sector, the requirements of the Solvency II Law are more flexible. They make allowance for more diverse situations, e.g. for medium-sized undertakings or those with a simpler structure, but this may also lead to an increase in the cases where an undertaking cannot adequately measure and control the risks associated with its activities. It must be

acknowledged that there is some contradiction between the requirements of the Directive, which regards risk management as a central feature in the organisation of insurance and reinsurance undertakings, and the exemptions possible under the Belgian law, some of which – as explained above – are not subject to any prior checks. In any case, the Bank will keep watch over the way in which the undertakings set up their governance system and the resources that they use to detect and control the risks inherent in their activities. From that point of view, it will also pay close attention to how the risk management function actually operates.

5.1.2 *Ex-ante* recovery plans

The Solvency II Law contains new provisions in relation to both the Directive and the earlier legislation regarding *ex-ante* recovery plans. The Bank may impose such a plan on certain undertakings on the basis of their size or their risk situation. The plan comprises measures that the undertaking is likely to implement if the risks foreseen in the plan actually materialise. However, pending European harmonisation on the subject, the Law does not lay down any general obligation requiring all insurers and reinsurers to draw up such a plan, not does it provide for the preparation of resolution plans by the Bank.

The recovery plan should be seen as preparation for the implementation of a consolidation programme or short-term financing plan that the undertaking may have to produce at relatively short notice if it fails to meet the solvency capital requirement (SCR) or the minimum capital requirement (MCR).

5.1.3 Preferential claims and separate management

The Solvency II Directive incorporates provisions from earlier Directives regarding preferential claims of insurance creditors. The EU legislation provides for two options which may be combined, namely an absolute preferential claim on the assets representing the technical provisions and a preferential claim on the whole of the assets. Exceptions to the latter preferential claim are claims by employees of the undertaking, the tax authorities and social security systems, and claims on assets subject to rights *in rem*.

The Solvency II Law uses both options offered by the Directive. Compared to the earlier situation, this places insurance creditors in a better position if the preferential claim on all the assets has to be exercised. Under the Law of 9 July 1975, that preferential claim ranked very low, making it virtually ineffective.

The claims accorded preference are assessed from the point of view of the liquidation of the insurance undertaking. In that situation, the contracts are terminated without being transferred to another undertaking which will take on the management of the existing portfolio or continue the business of the undertaking making the transfer. Since the policy-holders and insurance beneficiaries have to be paid out the amount of their claims, it is no longer possible to take account of future events such as contract redemptions or the discounting of compensation claims. The amount of these claims may therefore differ from that of the technical provisions shown in the Solvency II balance sheet.

On the other hand, the assets forming the basis of the preferential claims are stated at market value, as is normal under the other provisions of the Solvency II Law. To permit checking of the consistency of that basis, the Law obliges insurance undertakings to maintain a permanent register stating the assets which will thus be excluded from claims on the undertaking by other creditors.

The preferential claims are organised on the basis of each separate division, of which there are just two : life and non-life. It was considered that these were the only two divisions sufficiently consistent and stable to prevent manipulation of the basis of the preferential claims. Investment funds (mainly those in class 23) in which the policy-holder bears the investment risk form exceptions, as each one is a separate division in itself. The reason is that, for this type of contract, the claim is at all times equal to the assets forming the fund.

5.1.4 Small undertakings

The Solvency II Law contains a chapter devoted to undertakings excluded from the scope of the Directive (Article 4 of the Directive). This small number of undertakings, licensed pursuant to the Law of 9 July 1975, are subject to rules comparable to those under the aforesaid Law which permit account to be taken of their size and of the low risk inherent in their activities. For these undertakings, that is a practical application of the principle of proportionality.

So long as these undertakings have concluded an agreement providing for the reinsurance or total transfer of their liabilities, they qualify for almost total exemption from the provisions of the Solvency II Law.

Finally, for local insurance undertakings which confine their activities to covering simple risks in the municipality where they have their registered office or in neighbouring municipalities, it is proposed to revert – broadly speaking – to the rules in force up to 31 December 2009; that means virtually total exemption from supervision provided their activities remain limited and the undertakings take out reinsurance covering the major part of their risks.

5.1.5 Transitional provisions over 16 years

The Solvency II Law contains transitional measures taken over from the Directive. These allow insurers and reinsurers sufficient time to adapt to the new provisions, and to stagger the financial impact over time. Two of these measures concern the technical provisions over a 16-year period. One directly concerns the amount of the provisions (the transitional measure on technical provisions), while the other operates indirectly via the risk-free interest rate (transitional measure on the interest rate). The two measures are mutually exclusive, in that the use of one automatically rules out use of the other.

The amount of the transitional measure on technical provisions corresponds to the difference between the technical provisions under Solvency II and the technical provisions under Solvency I (including the additional provision and the provision for profit-sharing) on the portfolio of contracts in existence on 1 January 2016. This deduction is at its maximum in the first year and declines linearly at the end of each year, disappearing from 1 January 2032.

The transitional measure on the interest rate corresponds to the difference between the single discount rate for life insurance portfolio liabilities according to the Solvency I rules and the single discount rate according to Solvency II. This transitional measure decreases linearly over a 16-year period in the same way as the transitional measure on technical provisions. It can only apply to all the contracts in the life insurance portfolio concluded before the introduction of Solvency II. The extra workload that this measure entails, owing to its complexity, is such that few undertakings are likely to make use of it, either in Belgium or in the other Member States.

The application of the transitional measures is subject to the prior approval of the supervisory authorities. Since this transitional period is decidedly future-oriented, it is important for the Bank to have all the necessary information to assess the quality of this prospective valuation. Insurance undertakings seeking the Bank's approval will therefore have to compose a dossier for that purpose. The content of that dossier has been specified in a Circular.

5.2 Guidelines

5.2.1 Royal Decree on profit-sharing and the granting of rebates

The entry into force of the Solvency II Law made it necessary to adjust the rules on profit-sharing in line with the new prudential rules for insurance and reinsurance undertakings.

The prudential rules only concern profit-sharing applicable to all insurance contracts. The rules on the allocation of profits to specific contracts come under consumer protection and do not belong in a prudential Decree. Profit-sharing involves handing over all or part of the undertaking's profit to policy-holders and beneficiaries to offset the cautiousness priced into the tariffs. The amount is determined as a global figure for all the policy-holders concerned and incorporated in the insurer's technical provisions in the form of an allocation in the financial year to the provision for bonuses and rebates.

The main weakness of the old regulations was that the supervision of profit-sharing was based only on the annual accounting profitability of the insurance contracts, with no future-oriented view of the risks that the undertaking has to bear throughout the life of the contract. The Decree introduces a prospective approach via the criterion of the SCR coverage ratio.

The technical/financial profit, i.e. the net result of the actual insurance operations, plus the net financial result disregarding the allocation for the financial year to the provision for bonuses and rebates, is defined as the maximum amount that an undertaking may distribute in the form of profit-sharing.

On that basis, the Decree distinguishes between three situations. If the SCR coverage ratio is 100 % or more without the need to use the transitional measures provided for by the Solvency II Law (see 5.1.5 above), the undertaking may distribute the above amount without seeking the consent of the Bank. If that ratio is 100 % or more purely because the undertaking uses the transitional measures, the distribution is subject to the Bank's prior approval. Finally, if the ratio is below 100 % even with use of the transitional measures, no profit distribution is permitted. In this last case, however, the Bank may grant exceptional permission for the distribution of profits if the undertaking proves that there is no detrimental effect on its financial situation, e.g. because it has capital components which are not eligible for covering the SCR

and non-distribution would have adverse procyclical effects, such as mass contract redemptions.

The rules described above apply separately to life and non-life business.

5.2.2 Royal Decree on the annual accounts of insurance and reinsurance undertakings

The statutory annual accounts of Belgian insurance undertakings are currently governed by the Royal Decree of 17 November 1994 on the annual accounts of insurance and reinsurance undertakings, commonly known as BE GAAP for insurance. For the calculation of the technical provisions, that Decree is supplemented by the more detailed stipulations of the Solvency I framework. The entry into force of the Solvency II framework, replacing Solvency I, has severed that link between the accounting rules and the prudential rules. Furthermore, the Solvency II system does not contain any rules on accounting.

Considering these developments, the Bank consulted interested parties on a possible adjustment to the statutory accounting rules for the insurance sector. Those adjustments are not only in keeping with Solvency II, but also tie in with the revision of the rules on the calculation of profit-sharing, which mainly depends on the accounting result for the year.

The approach that the Bank proposes is to maintain the current philosophy of BE GAAP for insurance, which is based mainly on a symmetrical assessment of the insurance assets and liabilities according to historical cost and/or amortised cost. However, the Bank considered it advisable to propose tightening up these accounting rules by incorporating the prudential rules on calculation of the technical provisions under the Solvency I framework, those rules being more precise and cautious. This adjustment primarily concerns the supplementary (flashing-light) provisions which should continue to be included in the statutory accounts despite the switch to Solvency II. The statutory accounting standards for the insurance sector also need to be adjusted to take account of the power that the Solvency II Law conferred on the Bank to grant exemptions from the accounting rules.

5.2.3 Circulars relating to the EIOPA guidelines

The provisions of the Solvency II Directive, amended by the Omnibus II Directive, were supplemented by Delegated Regulation (EU) 2015/35 of 10 October 2014 and are subject to EC technical implementing standards (TIS) and EIOPA guidelines. The TIS and the guidelines were drawn up in two stages.

The stage 1 TIS and guidelines, which mainly concern the approval dossiers which undertakings have been able to submit since 1 April 2015, were published by EIOPA on 2 February 2015. The stage 2 guidelines and the guidelines on the governance system and those on the ORSA were published on 14 September 2015. The Bank prepared national Circulars to incorporate these guidelines into the Belgian legislation and submitted them to interested parties for consultation. In the case of certain guidelines, there is no specific Circular because those guidelines concern procedures to be included in the Bank's prudential supervision system.

The Bank will keep a close watch on the EIOPA guidelines. The Circulars were adapted on some points to take account of specific national characteristics, and additional clarification was provided in the Circulars on own funds. Also, to prevent distortion of competition between Belgian insurers, the Circular on contract limits includes an annex explaining how to apply those limits to certain specific products.

5.2.4 Circular on applications for approval and transitional measures

In the context of the gradual introduction of Solvency II (phasing-in), it is important to improve transparency and to provide further details on the information requirements and approval procedures relating to the various measures as laid down in Article 308a of the Solvency II Directive.

The use of some measures which come under the phased introduction of Solvency II requires the Bank's prior approval on the basis of a full application dossier. That approval will be granted on an individual basis, taking account of the specific requirements and additional factors relevant to the appraisal.

To improve transparency and provide further details on the specific requirements concerning the various approval procedures, the Bank sent out a Circular to the insurance companies.

Undertakings which intend to submit an application for approval for one or more of the transitional measures relating to the entry into force of Solvency II are required to provide the Bank with certain specific, relevant information. That concerns such matters as the use of the matching adjustment, the volatility adjustment, the transitional

measures on risk-free interest rates and technical provisions, ancillary own funds, company-specific parameters, and a full or partial internal model.

For the great majority of the measures, the Circular refers to the relevant EC implementing Regulations and the EIOPA guidelines. In the case of the transitional measure on technical provisions, the Bank imposes specific requirements for the content of the application dossier. This concerns the documentation of all relevant calculations, a standard reporting template showing the impact of the transitional measure, an assessment of conformity with the capital requirements with and without application of the measure, a capital management plan taking account of the application of the measure, and the results of standardised stress test scenarios entailing a balance sheet projection over 16 years. The Bank expects those projections to be sufficiently realistic and conservative.

5.2.5 Circular on reporting

The Circular on reporting for insurance undertakings sets out what the Bank expects in regard to the regular communication of information in the context of the implementation of the Solvency II Law. It essentially comprises a summary of all the provisions of the various regulatory texts on reporting under Solvency II.

In particular, it contains information on:
– the legal framework for reporting requirements,
– the exemption policy,
– the reporting structure,
– the content and date of the last report to be submitted under Solvency I,
– the content and submission date of the "Day-1" report and the first quarterly report under Solvency II in 2016,
– the content and submission dates of future quarterly reports,
– the content and submission dates of the annual quantitative reports.
– the content of the report on solvency and the financial position,
– the content of the information to be supplied regularly for supervision purposes,
– some practical guidance for reporting on financial stability and harmonisation with reports destined for the ECB, and
– the additional national requirements and means of communicating information to the Bank.

Box 14 – Adjustments to hospitalisation insurance tariffs

A health insurance policy is a contract which is, in principle, concluded for life and which cannot be cancelled by the insurer. Moreover, the law limits the scope for insurers to make changes to the technical basis of the premium and the conditions of cover under these contracts once they have been concluded.

However, health care costs are constantly rising and are difficult to predict at the time of conclusion of the contract. It is therefore inevitable that the premium has to be adjusted during the term of the contract (unless substantial margins are priced into the contract from the start).

There is also the problem of the ageing provision. This stems from the system of level premiums, which means that young policy-holders pay more than the premium needed to cover the risk. That surplus is set aside in the ageing provision to absorb the higher costs at a later stage in life. While the adjustment of the premiums via an index – which takes no account in the growth of the ageing provision – absorbs the increase in medical costs in the immediate future, it does not adjust the existing ageing provision in line with that increase.

In the case of non-occupation-related health insurance contracts, the insurers' options for adjusting the premiums and conditions of cover were originally restricted by law to the following three possibilities:
– by mutual agreement between the parties, at the request of principal policy-holder and solely in the interests of the persons insured,
– on the basis of the consumer price index,
– on the basis of one or more specific indices, known as the "medical indices".

Since the abolition of the third option in 2011, there are now only two alternatives for tariff adjustments by insurers, which implies that it is no longer permissible to increase a tariff by a percentage that exceeds the consumer price index. Without prejudice to these limited legal options for adjusting tariffs, under exceptional circumstances an undertaking may seek the Bank's consent to rebalancing its tariffs if it can show that the tariffs charged are – or risk becoming – loss-making. Since health care costs are rising faster than the consumer price index, and in view of the problem of the ageing provision, many insurers have been forced to do that.

Between 2013 and 2015, the Bank received nine applications for tariff increases from six different insurers. Of the nine applications, seven were approved either in whole or in part (the increase was permitted but only for part of the percentage originally requested) and two were refused.

The Bank examines these applications from a prudential angle. In contrast, consumer protection is an FSMA responsibility. This means that the Bank takes account of product profitability and decides on the basis of the factors generating that profitability. For that purpose, the undertaking has to supply, among other things, a short-term projection of its accounting results for the products in question, accompanied by the results of the portfolio over the entire period covered. An undertaking's cost structure is one of the objective data that determine profitability, but is not decisive. In 2016, the Bank will take steps to introduce a uniform, harmonised application dossier.

After obtaining the opinion of the FSMA, the Bank approves the increase if it considers that failure to adjust the tariff will lead to a situation which is loss-making, or likely to become so. In the case of some undertakings, the application submitted concerned a small or older health portfolio in run-off.

E. Financial market infrastructures

1. Introduction

There were further developments in the legislation on financial market infrastructures (FMIs) during the year under review. Section 2 presents the mapping of the sector. The oversight approach is traditionally based on principles rather than on detailed rules; the authorities use arguments to persuade FMIs (moral suasion) instead of punishing them with fines or other penalties. However, there is an evident shift away from this soft law approach towards hard law in the sense that the requirements are spelt out in laws for both payment systems and CSDs. Where CSDs are concerned, the Regulation on central securities depositories (the CSD Regulation) (1) transposes into European law the CPMI-IOSCO Principles for Financial Market Infrastructures. Apart from the publication of the Circular on recovery plans for FMIs, the main provisions of which are discussed in section 4 of the chapter on "Recovery and resolution", the regulations were further extended as explained in section 3 of this chapter.

Section 4 describes the supervision and oversight activities relating to the risks accorded priority attention in the Annual Risk Review 2015. More specifically, this concerns supervision of liquidity and credit risk, operational risk and the monitoring of the business models.

(1) Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012.

2. Mapping of the sector

The Bank is responsible for the oversight and prudential supervision of FMIs. The prudential supervision monitors the risks facing the FMI itself, while the oversight focuses on the security and efficiency of the system operated by the FMI. In particular, the oversight checks whether systemic infrastructures are capable of ensuring the continuity of their services in extreme circumstances. The table shows the Belgian infrastructures subject to the Bank's authority and the cooperation between the Bank and the supervisory authorities of third-country infrastructures.

The Bank grants authorisation for payment and electronic money institutions. The number of payment institutions has risen slightly since last year: one institution was licensed with full status (B+S Payment Europe) and two exempt institutions were authorised to offer payment services in Belgium (Rent A Terminal Belgium SPRL and

TABLE 7 THE BANK'S SUPERVISION AND OVERSIGHT OF FINANCIAL MARKET INFRASTRUCTURES

	Institutions / systems subject to supervision and oversight		
	The Bank acts as the sole authority	International cooperation	
		The Bank acts as the lead authority	The Bank participates, another authority is lead authority
Prudential supervision	Belgian branch of Bank of New York Mellon (BNYM) Payment and electronic money institutions		BNYM SA/NV
Supervision and oversight	BNYM CSD Worldline Belgium	Euroclear Bank Euroclear Belgium Euroclear SA/NV	CCP Colleges [2]
Oversight	NBB-SSS Bancontact / MisterCash [1] Centre for Exchange and Clearing [1] MasterCard Europe [1]	SWIFT [3]	TARGET2 TARGET2-Securities CLS [4]

Source: NBB.

(1) Peer review in the Eurosystem / ESCB.

(2) These are the supervisory colleges for the central counterparties LCH.Clearnet SA, LCH.Clearnet Ltd, EuroCCP, Eurex AG Clearing, CC&G, ICE Clear Europe, KDPW-CCP and Keler CCP.

(3) Society for Worldwide Interbank Financial Telecommunication.

(4) Continuous Linked Settlement.

Belmoney Transfert SPRL). One exempt institution ceased its activities. Two of the three new institutions operate in card payment systems, which reflects the changing market conditions in the card payment sector. In the electronic money sector, there were no changes in the number and status of the institutions in 2015. Altogether, there are 20 institutions offering payment services in Belgium and 11 which can issue electronic money; this number is set to rise owing to the new regulatory framework applicable to payment services.

TABLE 8 NUMBER OF PAYMENT AND ELECTRONIC MONEY INSTITUTIONS SUBJECT TO SUPERVISION

	31-12-2014	31-12-2015
Payment institutions	18	20
Under Belgian law	11	12
Exempt institutions [1]	4	5
Branches governed by the law of an EEA member country	3	3
Electronic money institutions	11	11
Under Belgian law	5	5
Exempt institutions [1]	5	5
Branches governed by the law of an EEA member country	1	1

Source: NBB.

(1) Pursuant to Article 48 of the Law of 21 December 2009, "exempt institutions" are subject to a lighter regime comprising only the obligations arising from Articles 21 and 22 of that Law.

3. Legislation

In the wake of the operational incidents at Worldline SA in 2014 and 2015, it was suggested that it might be advisable to introduce a stringent law governing the supervision of payment systems in Belgium. Worldline handles virtually all Bancontact/Mister Cash transactions in Belgium and a large proportion of other card payments. Consequently, Worldline is systemically important for payment transactions on the Belgian market and the company is subject to the oversight of the Bank.

After many years without a hitch, there have been seven incidents altogether in the past two years, three of which attracted extensive media coverage, while the others had little or no impact on the general public's payment transactions. Since operational continuity is crucial to the smooth flow and reliability of payments traffic in Belgium, questions were asked about whether oversight based on soft law is sufficiently effective. The current oversight role, based on moral suasion, may therefore by supplemented by hard law in order to safeguard the efficiency and stability of critical payment infrastructures.

A more stringent supervision law might, for example, impose requirements on payment transaction and payment scheme operators in Belgium in regard to such matters as operational stability (data confidentiality and integrity and system availability), transparency and communication. The stability and continuity of the processing of payments in Belgium must continue to be guaranteed, not least because the payment card industry is slowly but surely progressing towards a Single Euro Payments Area (SEPA), with moves to consolidate in order to achieve economies of scale, which could have a significant impact on the national payment infrastructures.

As foreseen by the 2007 Payment Services Directive, the EC launched a review in 2012 which led to a revision of the Directive in 2015. To make payment services more transparent and competitive, the European Parliament and the Council broadened the playing field under the new Directive[1], paying particular attention to the security of payment services offered to the public. The revised Payment Services Directive, published on 23 December 2015, has to be transposed into national law by 13 January 2018. In comparison with the previous Directive, the scope has been extended to two types of payment services which were not previously subject to authorisation: payment initiation services and account information services.

Payment initiation services and account information services never hold the payers' funds. They only provide services to initiate payments or to collect account information with the express approval of the payment services user. They must ensure that personal security data are not accessible to other parties, and must communicate with the parties concerned in a secure manner. To ensure that any incidents are followed up directly and speedily, payment service providers will be obliged to report any significant operational or security incidents.

The new Directive also makes provision for the creation of a central register at European level containing lists of all payment institutions authorised in Europe. This will enable all payment service users to consult a central register comprising the data from all national registers of payment service providers.

Although cryptocurrencies (also known as virtual or digital currencies) such as Bitcoin do not constitute a payment system and the Bank has no authority over them, it keeps a close watch on the associated problems. As a payment

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

instruments regulator, it repeated the warning it issued in 2014 about the risks associated with virtual money. The Bank stressed once again that cryptocurrencies are not legal tender nor are they a form of electronic money, there is no financial supervision or oversight of cryptocurrencies, and these products are therefore risky. During the year under review, the Bank took part in two pieces of work on this subject. One was the ECB's February 2015 report entitled "Virtual currency schemes – a further analysis", which was an extension of an initial analysis of virtual currencies conducted in 2012 [1], and the other was the report on digital currencies published by the CPMI [2]. Apart from the actual virtual currency schemes, the Bank is also interested in the new technologies that cryptocurrencies have brought (distributed ledgers) which could have a significant impact in the future on the operation of payment systems and instruments.

In regard to the CSD Regulation, last year saw the designation of the competent authority in Belgium, and further work on the technical standards. On 11 June 2015 [3], the Bank was designated as the competent authority responsible for carrying out the duties referred to in the CSD Regulation on the authorisation and supervision of CSDs, without prejudice to the specific responsibilities of the FSMA.

Three CSDs are currently operating in Belgium : Euroclear Bank, Euroclear Belgium and NBB-SSS. However, the authorisation obligation does not apply to this last CSD which is run by the central bank, although NBB-SSS has to conform to most of the requirements of the CSD Regulation. Furthermore, CSDs which themselves offer services relating to settlement in commercial bank money must obtain authorisation for the provision of banking-type ancillary services, in addition to their CSD and credit institution licences. That obligation applies to Euroclear Bank.

The CSD Regulation requires the Bank to consult the relevant authorities before granting authorisation to CSDs or authorising the provision of banking-type ancillary services, and in reviewing the authorisations at least once a year. The authorities concerned, specified in the CSD Regulation, are the ones for which the smooth operation of the CSD is important, e.g. the overseer [4] of the CSD, the central banks which issue the main currencies in which settlement is made, and the authorities of the countries for which the CSD is important. In that connection, it is worth noting that – separately from the CSD Regulation – the Bank intends to conclude an oversight cooperation agreement for Euroclear Bank, in accordance with the CPMI-IOSCO principles, with the central banks which represent the main currencies in the system.

The CSD Regulation empowers the European Securities and Markets Authority (ESMA) and the EBA to develop technical standards, in close cooperation with the members of the ESCB, and submit them to the EC, for the purpose of specifying the following in more detail (indicative list) :

- the information that the CSD must supply to the competent authority in the authorisation application ;
- the conditions under which the EU currencies are considered the main currencies ;
- the reconciliation measures to be taken by the CSDs ;
- the operational risks for links between CSDs and the methods of measuring, managing and reducing those risks ;
- the financial instruments which can be considered highly liquid with a minimal market and credit risk, and in which the CSD is permitted to invest its financial resources ;
- the tools for monitoring, measuring and managing (primarily intra-day) credit risks and liquidity risks.

The Bank was closely involved in the development of these technical standards which are scheduled for publication early in 2016. The CSDs must apply for the necessary authorisations on the basis of the CSD Regulation within a maximum of six months following publication of these technical standards.

(1) *Virtual currency schemes*, ECB, October 2012.
(2) *Digital Currencies*, CPMI, November 2015.
(3) Royal Decree of 11 June 2015 designating the competent authority responsible for the authorisation and supervision of central securities depositories.
(4) The Bank's responsibility as overseer is thus maintained as regards implementation of the CSD Regulation. In particular, that makes it possible to take account of changes in the international principles applicable to CSDs and impose compliance with those principles.

4. Oversight and supervision of FMIs

4.1 Liquidity risk and credit risk

During the year under review, the Bank played an active role in the discussions on the CSD Regulation's technical standards relating to liquidity risk. Moreover, that is one of the priorities of the 2015 Annual Risk Review for FMIs. In the case of international CSDs (ICSDs), liquidity risk is not only monitored as part of the prudential supervision but is also kept under close vigilance via oversight reporting which takes more account of the specific characteristics of FMIs. For instance, oversight reporting considers the intra-day risk (whereas prudential reporting is based on end-of-day figures) and reveals links with the settlement and other activities of the (I)CSD.

In view of the specific characteristics of (I)CSDs, and to supplement existing bank legislation, the CSD Regulation introduces rules on the management of intra-day credit risks and liquidity risks. In that connection, very close attention is paid to the management of the collateral that participants pledge to the (I)CSD. Another important point is the requirement for (I)CSDs to have sufficient liquid resources to cope with the simultaneous default of the two participants with the largest debit position. The CSD Regulation goes further here than the Principles for FMIs, which state that (I)CSDs must at the very least be able to withstand the default of the participant with the largest debit position.

Such stringent requirements are justified for CSDs in view of their systemic importance, as CSDs play a leading role in the settlement of stock market and off-exchange transactions between market counterparties. These systems are also used for mobilising and managing the collateral which is exchanged to cover the risks inherent in certain transactions, such as repos, or monetary policy or credit transactions, but also to meet the margin requirements of central counterparties (CCPs).

When CSDs process the purchase or sale of securities, the cash leg of the transaction is recorded on the account of either a central bank (central bank money) or a credit institution (commercial bank money). In the latter case, the CSD Regulation stipulates the use of a single-purpose bank, i.e. a credit institution which does not engage in any activities other than the settlement of the cash leg of securities transactions, in order to minimise the risks to that bank. In Belgium, the securities settlement systems settle transactions either in the books of the Bank (NBB-SSS and Euroclear Belgium) or in those of Euroclear Bank (the only future single-purpose bank in Belgium).

(I)CSDs that provide credit to their participants (in various currencies) – such as Euroclear Bank – may be exposed to credit risk and liquidity risk. This mainly concerns intra-day risks because, in principle, participants settle their accounts before the end of the day. Both the Principles for FMIs and the CSD Regulation require these credit risks relating to participants to be covered by collateral (or other equivalent financial resources). The Bank keeps a very close eye on the degree to which intra-day risks are covered at Euroclear Bank.

If a participant is unable to meet its liabilities, Euroclear Bank can liquidate the collateral. Since the proceeds of the liquidation or sale of the collateral are not available immediately, Euroclear Bank must have sufficient financial resources to bridge the gap. Part of the available liquid resources comes from the cash surpluses that participants leave on their account at Euroclear Bank. These can be used for routine liquidity risk management or – at least partially – in a crisis situation. While the surpluses contribute towards the liquid resources, they also create credit risks in that they are invested on the interbank market. The Bank pays due attention to the size of these cash surpluses and examines the degree to which the investments are covered by collateral (reverse repo).

Since Euroclear Bank's liquidity needs originate from providing credit to its participants, the Bank as the overseer keeps an eye on the trend in use of credit. In that connection, it takes a closer look at the links between the activities of Euroclear Bank and the resulting credit risks. Similarly, specific attention focuses on the liquidity needs and resources in various currencies, and the interdependence between Euroclear Bank and other market infrastructures such as CCPs or other (I)CSDs.

4.2 Operational risk

A second priority in the year under review was the operational risk including cyber risk (discussed in section 3 of the next chapter on "Cross-sectoral aspects of prudential regulation and supervision"). The oversight approach to operational risk goes well beyond the capital requirements for operational risk. Given the systemic importance of the financial market infrastructures, the availability of their systems is crucial. This aspect therefore takes up most of the attention in the monitoring of IT projects. Concerns about the timely delivery of a new platform or control of the associated costs must not take precedence over the stability of the financial system.

The Bank is the lead overseer of SWIFT (Society for Worldwide Interbank Financial Telecommunication). SWIFT is subject to central bank oversight because it is crucial to the security and efficiency of the financial messages exchanged between financial institutions and financial market infrastructures throughout the world. The oversight of SWIFT is conducted by the G10 central banks, while the oversight programme and findings are examined by a larger group in the SWIFT Oversight Forum, in which ten other central banks also participate.

The oversight activities concern all types of operational risks associated with SWIFT messaging services. Cyber risk was again the focus of greatly increased attention during the year under review. The development of mechanisms protecting against cyber threats is ongoing. As part of a continuous assessment, better ways of detecting, protecting against and responding to cyber threats are being examined, taking account of the changes in the nature of cyber threats and the new protection solutions gradually becoming available.

The modernisation of the FIN application, central to the SWIFT messaging services, continued during the year under review. This thorough technological overhaul was conducted without impairing the availability of the messaging services for customers. The monitoring of this multi-annual project was another key priority during the year under review. In the past few years, there has been increasing diversification in the services that SWIFT provides for financial institutions, e.g. with the development of solutions assisting them in their reporting obligations to the supervisory authorities. Another point of interest for overseers is therefore the degree to which this increasing diversification of services influences the risk management of SWIFT as a whole.

4.3 Business model analysis

The monitoring of FMIs' business models in a changing environment remains a priority for supervision and oversight. The growing need for collateral, and hence for collateral management services, is a trend that has been in evidence for some years now. The obligation to use a central counterparty for clearing standardised over-the-counter (OTC) derivatives will not only increase the need for collateral or margin, but will also mean that the frequency with which counterparties have to exchange collateral will increase from a weekly or monthly cycle for transactions not cleared in a CCP to more intra-day margin calls. In addition, many counterparties (including CCPs and central banks) have their own definition of eligible collateral. Market players who are very active on the repo markets or in multiple CCPs therefore need an efficient platform for transferring securities (sometimes even intraday) accepted by their various counterparties. In view of the market players' ever-increasing need for collateral, efficient allocation of the collateral is necessary to avoid any (real or apparent) shortages.

For quite a few years now, Euroclear Bank has offered collateral management services which were recently grouped under the name Collateral Highway. This platform enables customers to mobilise their securities efficiently (whether they are on an account with Euroclear or with a partner) and transfer them to the counterparty who needs them as collateral. These services are offered not only to customers of Euroclear Bank but also to customers of other CSDs in the Euroclear group, as the services have been extended to local Euroclear CSDs. The joint venture between Euroclear and the American CSD Depository Trust & Clearing Corporation (known as DTCC-Euroclear Global Collateral Ltd) is another major extension of the Collateral Highway. The joint venture will enable customers to manage their margin obligations efficiently and simplify the mobilisation of the necessary collateral (from the American CSD). Mid-2016 will see the launch of the first part of the platform, namely the Margin Transit Utility (MTU), which will handle the processing of margin obligations. The second part, the Collateral Management Utility (CMU), which will deal with the mobilisation of

collateral, will be launched a few months later. The Bank's approval was required in the same way as for all strategic decisions by systemic institutions. The competent authorities of the United States and the United Kingdom (as the joint venture is based in Britain) will also have to approve the project.

The business models of the Belgian BNYM entities were also monitored. This year, as part of an exercise whereby the group's presence, and its activities and the markets to which access is proposed, are continuously adapted to the financial and regulatory context, the BNYM group made various changes affecting the group entities in Belgium.

One important change with regard to its positioning is the group's decision to connect to the TARGET2-Securities platform as a directly connected participant. That decision implied direct access to TARGET2 for BNYM SA/NV and led to the gradual replacement of its access to the infrastructures of the main European markets via sub-depositories by direct access. The group consequently decided to put its central securities depository BNYM CSD SA/NV on standby.

The BNYM group also opted to refocus the activities of BNYM SA/NV on securities management, by terminating its activities as a member of clearing institutions on behalf of its customers operating in derivatives and by transferring its securities lending and borrowing activities to the Bank of New York, London Branch.

The Crisis Management Group (CMG), set up in accordance with the FSB's guidelines on Key Attributes of Effective Resolution Regimes for Financial Institutions, is interested in the organisation of the BNYM group's activities, as this group is considered to be a Global Systemically Important Financial Institution (G-SIFI), i.e. an institution which, owing to its size, activities and deep embedding in the financial network, is of systemic relevance in the financial world.

Since 2013, a CMG meeting has been held every year for BNYM, organised alternately by the Federal Deposit Insurance Corporation and the Federal Reserve Bank of New York. The Bank is also represented on the CMG, as are the Board of Governors of the Federal Reserve System (United States), the Bank of England (United Kingdom), the Prudential Regulation Authority (United Kingdom) and – for the first time in 2015, as observers – the ECB and the Single Resolution Board (SRB). The CMG focuses in particular on the international configuration of the BNYM group, its presence in over 100 markets, the monitoring of transnational outsourcing and the degree to which its operational continuity can be guaranteed or improved.

F. Cross-sectoral aspects of prudential regulation and supervision

1. Introduction

In recent years, in its capacity as a supervisory authority, the Bank has played an active part in the work of the Financial Action Task Force (FATF) on combating money-laundering and terrorist financing. Section 2 of this chapter discusses Fourth Round Evaluation Report on Belgium. The report indicates that while Belgium has a robust system for the prevention of money-laundering and terrorist financing, it does not conform fully to the recommendations in some respects. In response to these findings, the Bank decided to conduct an in-depth review of the organisation of its supervisory powers on the subject.

During the year under review, technological progress also had a significant impact on the financial sector. Thus, the ever-growing importance of digitalisation led to the market entry of suppliers of software and applications supporting financial services, positioned alongside the traditional market players. Established players are responding to this trend by developing new applications or business models themselves, and/or by collaborating with these new entrants. This could entail new risks, and requires heightened vigilance, as explained in section 3.

Owing to the steady advance of digitalisation in the management of financial transactions and non-cash money and the importance of the internet in the financial sector, a detailed analysis of cyber risk management has become a priority for the prudential supervisor. Section 4 explains how the Bank addressed this need during the year under review, e.g. by issuing a Circular to systemic institutions clarifying its expectations regarding operational continuity and security, and taking an active part in the international efforts to improve cyber resilience.

2. Combating money-laundering

The Fourth Round Evaluation Report on Belgium was published on the website of the Financial Action Task Force (FATF) after being discussed at the plenary meeting of that international organisation on 26 February 2015. This report concludes that Belgium has the core elements of a sound anti-money-laundering and counter-terrorist financing (AML/CFT) regime, although some elements are not yet fully in line with the forty 2012 FATF Recommendations.

As regards the technical conformity of Belgium's provisions and mechanisms with those recommendations, it should be noted that the Belgian laws and regulations evaluated were still based on the previous version of the FATF recommendations. Consequently, the level of conformity found in Belgium in 2015 was lower than at the time of the third mutual evaluation by the FATF in 2005. However, that situation is temporary, and will be largely remedied by the transposition of the Fourth EU Anti-Money-Laundering Directive [1] and entry into force of the new EU Regulation [2] on information accompanying transfers of funds.

The evaluation of the effectiveness of the AML/CFT measures applied in Belgium likewise presents a mixed picture. While the effectiveness of these measures is assessed as substantial in regard to four of the eleven immediate outcomes defined by the new FATF evaluation methodology, it is assessed as moderate in regard to the other seven immediate outcomes. That result is attributable partly to the short time that Belgium was given to adapt to the new effectiveness requirements based on the evaluation methodology adopted by the FATF in February 2013.

In regard to the financial sector, a positive point is that the FATF found that companies in this sector have a good understanding of their prevention obligations and the risks to which they are exposed, and that the financial institutions generally seem to take appropriate preventive measures, including in high risk situations.

However, the report regrets that the supervision that the Bank exercises in this matter on the basis of assessment of the prudential risks does not take sufficiently clear and specific account of the assessment of the risks of money-laundering and terrorist financing associated with each of the supervised institutions. The available remote supervision tools need to be improved in that respect. The frequency of its on-site inspections also needs to be stepped up significantly in order to permit better supervision of the effectiveness of the measures applied by the financial institutions and to gain a more continuous insight into the risks. The FATF therefore recommends that the Bank should make more frequent use of its powers to impose sanctions where that is justified by the seriousness of the shortcomings found. In addition, the FATF considers that the Bank should do more to raise the awareness of the financial sector. The report emphasises that, in order to meet all these specific recommendations, the Bank needs to allocate more resources to AML/CFT supervision.

In view of the results of its evaluation, Belgium has to report annually to the plenary meeting of the FATF on the measures that will be taken to conform to the specific recommendations addressed to Belgium in the FATF report and to improve the level of technical conformity and effectiveness of its AML/CFT arrangements.

In the meantime, the above-mentioned Fourth EU Directive has been adopted and published, and preparations are

(1) Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, Official Journal of the European Union, L141 of 5 June 2015.

(2) Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No. 1781/2006, Official Journal of the European Union, L141 of 5 June 2015.

under way for its transposition into Belgian law with the Bank's participation. The new European Regulation on information accompanying transfers of funds was published on the same day as the Directive and will apply from 26 June 2017, by which date the legal provisions transposing the Directive into national law must also be in force.

Taking account of the findings set out in the Mutual Evaluation Report and the FATF's recommendations addressed to the Bank, the latter also decided to conduct a fundamental review of the organisation of its AML/CFT supervision powers. The new set-up puts the emphasis on increased specialisation of the staff responsible for the remote monitoring of AML/CFT by bringing them together in a specialist group in charge of the prudential supervision on the subject. In addition, the staff assigned to this team are considerably specialised and their numbers are being increased. This team will carry out its duties in close cooperation with the inspection service, which will also have more resources allocated to on-site AML/CFT inspections. This reorganisation will make it possible to define and implement a supervisory approach specifically based on an assessment of the risks of money-laundering and terrorist financing to which each of the supervised financial institutions is exposed, so that the frequency and intensity of the supervision – both remote monitoring and on-site inspections – can be tailored more closely to those risks. Nevertheless, close links will also be maintained with the teams in charge of the general prudential supervision.

As regards its supervision tools, in 2015 the Bank continued with the process launched in 2013 of gradually developing and refining a periodic questionnaire on the prevention of money-laundering and terrorist financing which supervised financial institutions must complete each year. Thus, via a Circular dated 7 October 2015 the Bank sent out the new questionnaire which institutions must complete before the end of February 2016 on the basis of their situation as at 31 December 2015 [1]. The main innovation in this third version of the annual questionnaire, introduced after consultation with the professional associations of the financial sector and the insurance sector, is that it now includes a new section designed to collect the quantitative data that will enable the Bank to improve its knowledge of each financial institution's classification of its customers and business relationships on the basis of its assessment of the associated money-laundering and terrorist financing risks. Quantitative data are also collected to provide a better understanding of the process for the production and analysis of internal reports on atypical transactions and the process for reporting suspicious transactions to the Financial Intelligence Processing Unit (CTIF-CFI).

The abridged questionnaire that small payment institutions and electronic money institutions have to complete each year was also supplemented with a section on the collection of the same type of quantitative data, but with due regard for the principle of proportionality [2].

As well as forming an extension of the process begun in 2013, this adjustment to the periodic questionnaire is also an initial, partial response to the recommendation made by the FATF to the Bank in the said Fourth Round Mutual Evaluation Report on Belgium, in order to refine and perfect its AML/CFT supervision instruments.

(1) Circular NBB_2015_26 of 7 October 2015 on the periodic questionnaire on the prevention of money-laundering and terrorist financing.
(2) Circular NBB_2015_27 of 7 October 2015 on the short-form periodic questionnaire on the prevention of money-laundering and terrorist financing.

3. FinTech : technological innovation in the financial sector

The central role of the processing and exchange of data in the provision of financial services has led to a high degree of digitalisation in the financial sector. FinTech is a generic term for firms that offer software and applications supporting the provision of financial services. The Bank notes that growing numbers of IT start-ups focus on the development of this type of software and applications, and position themselves alongside the traditional market players. It expects this digitalisation to have a significant impact on the financial sector, and therefore analyses the associated risks.

FinTech start-ups develop alternative approaches to the supply of financial products, e.g. new business models for consumer credit, national or international payments, and investment advice. Established players are responding to this trend by developing new business models and applications themselves, and/or by collaborating with these start-ups.

FinTech firms have the potential to bring about fundamental changes in specific segments of the financial sector, to improve the customer's experience and to cut costs.

Various techniques are used to improve the customer's experience. Expertise in data management and analysis is used to create accurate customer profiles, enabling the software and the products or services offered to be tailored to the customer's preferences. Particular attention focuses on the design of interfaces, with the emphasis on user-friendliness. In addition, the use of financial software on online platforms, such as online retailers, leads to simplification and, in many cases, faster processing of the transaction.

Alternative business models and processes generally combine ease of use with cost reduction. FinTech start-ups mainly opt for market segments offering large margins, and not necessarily a full range of products or services. By offering the software and applications worldwide, it is possible to reap economies of scale. Many FinTech solutions drive down the costs to the end user via extensive disintermediation. For example, in the case of consumer payments, there are solutions which are no longer based on correspondent banking relationships. In lending, banks can be circumvented by direct contact between the borrower and the lender via internet platforms (peer-to-peer finance model). These new models and processes may generate new risks (e.g. as regards compliance and regulation) which need to be analysed and monitored.

In contrast to the FinTech newcomers, existing financial institutions have developed an extensive framework of financial services systems supporting the full range of products. Financial institutions have the necessary expertise to respond to the compliance and regulation challenges. They have established strong networks with other financial institutions and have a relationship of trust with the end user. It takes substantial investment to set up such a framework.

Banks are aware of the large productivity gains achievable in the financial sector if they can link their own financial framework to new solutions from FinTech firms. The challenge for the banks lies in optimising and opening up this financial framework to prevent the FinTech solutions from evading their sphere of influence. In the resulting new ecosystem, end users will enjoy an extended range of innovative and reliable products and services.

4. Cyber risks

Digitalisation and the importance of the internet in the financial sector continue to grow, stimulated partly by innovative newcomers and the further rationalisation of the IT resources used. Financial institutions and FMIs are making ever-increasing use of specialised software/hardware components and service providers for the development and management of data systems (examples include the growing use of external clouds for data storage and processing).

Financial institutions and FMIs manage the information systems for the storage of non-cash money, the processing of financial transactions and the management of (confidential) financial customer data. These systems must be adequately protected against various forms of cybercrime, cyberespionage and cyberterrorism. An in-depth assessment of the management of cyber risk is among the top priorities of the prudential supervision and oversight of financial institutions and FMIs.

4.1 Sharp rise in cyber threats

Cyber risk analyses revealed various cyber threats. Major threats for the immediate future include the growing use of externally developed software/hardware components and external service providers, dependence on a small number of technologies, long-term, targeted attacks and the presence of unreliable insiders.

The use of externally developed software/hardware components and external service providers involves three cyber risks. Thus, the integrity of an FMI's infrastructure may be impaired if it is managed by an external service provider. That may occur in various ways, e.g. by the deliberate or involuntary installation of malware, the alteration and/or deletion of data, or changes to configurations. Moreover, compromised systems of service providers may create access to the systems of the financial institution or FMI. Finally, software/hardware components bought in by the institution may incorporate methods of circumventing the data system's authentication processes (back doors).

Recent events have shown that commonly used basic technologies may have significant defects which undermine the good protection of the system, e.g. via a leak in the cryptography (Heartbleed). These defects, which are not always known to the technology developers, are found in many different applications. Long and complicated processes for updating the technology lead to additional exposure. Security experts predict that cyber criminals will continue to invest in tracking down these defects.

The number of advanced persistent threats is also expected to rise. For example, if cyber criminals are able to keep the attacks hidden from the system managers, data may be extracted over a long period. The development and use of these techniques generally require advanced specialist knowledge, which means that only a small number of groups have the necessary skills. However, these techniques are currently offered on the black market in user-friendly applications, and are therefore available to a broader public.

Apart from external threats, organisations also face unreliable insiders. An unreliable insider is an organisation's employee, subcontractor or other partner who abuses his access to the organisation's data systems in order to damage the organisation. Possible abuse includes the intentional publication of internal documents, the alteration or destruction of confidential data, and the restricting or blocking of access to data systems and/or confidential data.

4.2 Guidance on cyber resilience

During the year under review, the Bank drew up a prudential Circular for systemic institutions, defining

the prudential expectations regarding operational business continuity and security with special attention to cyber resilience. That Circular came into force on 1 January 2016. Subjects covered include raising awareness of security in software development, the physical and logical segmentation of internal IT systems, the use of strong authentication solutions for privileged administrator access to critical or sensitive IT systems, and the periodic organisation of large-scale security tests in which independent experts check the effectiveness and quality of the security on the basis of realistic attack scenarios carried out in an ethical manner.

The Bank plays an active part in the CPMI-IOSCO working group for the development of guidance regarding cyber resilience for FMIs. In 2015, the working group published a consultative paper setting out five categories of measures for the management of cyber risks and three general components. The five categories of measures are: cyber governance, identification of cyber risks, protection against cyber attacks, detection of cyber incidents, limitation of the impact of cyber incidents, and recovery after cyber incidents. The three general components are continuous testing of data systems, awareness of developments in the organisation's environment, and continuous improvement of cyber security strategies on the basis of acquired insight. Investments in the various categories of measures are mutually complementary. This guidance supplements the CPMI-IOSCO principles for financial market infrastructures. It clarifies and supplements the governance requirements (principle 2), the framework for comprehensive risk management (principle 3), settlement finality (principle 8), operational risk management (principle 17) and the links between financial market infrastructures (principle 20).

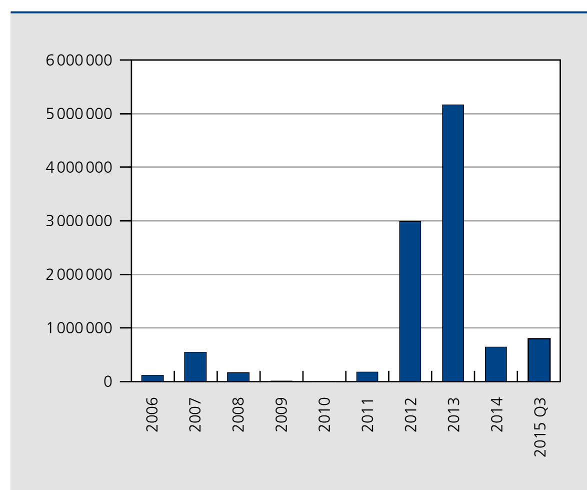
4.3 Cyber risk analysis

In 2015, both the prudential supervision and the oversight accorded particular importance to securing financial institutions and FMIs against cyber risks. European and international cooperation is becoming ever more important in that respect. Thus, in 2015, the SSM conducted a cross-sectoral review of cyber security covering the 130 largest banks and banking groups in Europe (the banks considered significant). On the basis of that review, other supervision measures were planned and carried out, including a number of targeted on-site inspections. In addition, a group of IT experts has been established in the SSM to improve the coordination, steering and monitoring of the supervision of the various IT risks and cyber risks specific to the sector as a whole. A new working group was also set up at the EBA for IT supervision, which will accord due attention to cyber risks as well as to the various IT risks. Another important platform for cooperation in combating cyber risks is the SecurePay Forum for the security of internet payments in Europe.

The close cooperation with entities such as Febelfin and the Federal Computer Crime Unit with a view to limiting e-banking fraud continued in the year under review. In this respect, it is worth noting that in 2015, as in 2014, instances of e-banking fraud remained stable at a low level in Belgium, notably as a result of the efforts made by financial institutions and following some successful arrests by the Belgian police and judiciary. As in 2013 and 2014, cases of e-banking fraud committed against private individuals in 2015 were due almost exclusively to fraud techniques whereby cyber criminals deceive users of e-banking into disclosing their personal security codes (usually after a telephone call or via a rogue website). In 2015, there were a few cases of fraud which specifically concerned professional e-banking channels and which used malware.

For the time being, the expansion of mobile banking services (via smartphone or tablet) has not led to any notable rise in the number of fraud cases in Belgium. The Bank is working with the sector to monitor the existing threats and the security solutions adopted by financial institutions.

CHART 10 ANNUAL FINANCIAL LOSS DUE TO E-BANKING FRAUD IN BELGIUM
(in €)



Source: NBB.