B. Recovery and resolution

Work on devising the single mechanisms for risk prevention and risk-sharing in the financial sector continued in 2016. The Bank further refined its provisions on recovery plans. It assessed the simplified recovery plans of eleven less significant banks and gave feedback on possible improvements. The Bank also began its periodic review of the value of the indicators relating to encumbered assets.

On 1 January of the year under review, the Regulation introducing the Single Resolution Mechanism entered fully into force and the Single Resolution Fund was set up. In Belgium, the transposition of the Bank Recovery and Resolution Directive (BRRD[1]) was completed, notably by provisions on resolution financing, the establishment of the Belgian Resolution Fund, and the application of the Directive to investment firms. The European Commission took various legislative initiatives, aimed among other things at facilitating the implementation of the bail-in mechanism, harmonising the application of the minimum requirement for own funds and eligible liabilities (MREL), and transposing the total loss-absorbing capacity (TLAC) into European law. The work on drawing up resolution plans also continued, but is a multiannual process.

The recovery and resolution mechanisms concerning insurance companies and financial market infrastructures are still being developed in the international forums in which the Bank participates. In Belgium, the Bank has imposed a recovery plan on four insurance companies and, as the prudential supervisory authority, takes part in a Crisis Management Group for a large foreign insurer. The Bank refined the provisions on recovery plans for financial market infrastructures and analysed the plans of a number of infrastructures subject to its supervision. International guidelines on the recovery and resolution of central counterparties are expected during 2017.

1. Banks and investment firms

1.1 Recovery plans

A recovery plan is a management strategy aimed at preventing a credit institution from failing when faced with a very severe shock.

Full recovery plans

The recovery plan presents not only an analysis of options that might be taken in order to recover from a severe shock but also a recovery plan monitoring framework, which includes a set of indicators designed to detect stress at a sufficiently early stage to allow institutions to take action to prevent a severe shock from occurring.

The Bank published an update of its April 2015 Communication describing the content of the recovery plans[2]. The updated version of the Communication contains a list of specific indicators that are required by EBA guidelines to be included in recovery plan monitoring frameworks[3].These indicators are classified in the categories of capital, liquidity, profitability, market-based indicators, and macroeconomic indicators.

(1) 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.

(2) NBB Communication NBB_2016_45 of 21 December 2016 "Recovery plans – Guidelines for credit institutions".

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

Simplified recovery plans

Under the Banking Law[1], the authorities may decide that institutions which are not of systemic importance qualify for the simplified recovery plan obligations, since the institution's failure and subsequent resolution according to the normal insolvency procedure would usually be unlikely to have major adverse repercussions on the financial markets, other institutions, financing conditions or the wider economy.

In 2015, the Bank decided that eleven less significant banks were eligible for the simplified recovery plan regime and that their plans should be submitted to the Bank by 31 December. The plans were assessed in 2016 and each credit institution received feedback by post. Since the preparation of a recovery plan is an exercise involving a particular type of analysis, and since – for small banks with limited resources – the simplified recovery plans were their first attempt at drafting such plans, the feedback was intended to indicate ways of improving the plans and developing them further. Common areas where additional development or explanation would improve the plan include providing more justification regarding the feasibility of certain recovery options cited in the plan and setting appropriate early warning and recovery threshold values for the indicators included in the recovery plan monitoring framework.

Asset encumbrance indicators

The Banking Law stipulates that credit institutions must include asset encumbrance indicators in their recovery plan monitoring framework. This requirement is specific to Belgium and is not imposed by the BRRD. Asset encumbrance indicators are meant to ensure that, in the event of failure, the quantity of assets available is always sufficient to cover the preferential deposits. The Banking Law in fact requires banks to take account of two encumbered asset indicators which differ according to whether they use a "narrow" or "broad" interpretation of the available assets[2]. The Regulation on Asset Encumbrance which accompanies the Banking Law defines these two indicators, and a Communication dating from 2015 provides detailed instructions on their calculation. In 2016, the Bank fine-tuned the definition of the narrow asset encumbrance indicator to take account of a change in the rules on liquidity used in the definition of this indicator[3].

The Bank also began regular monitoring of each bank's asset encumbrance indicator values. This process involves first identifying banks for which an indicator value is close to or has breached an early warning or recovery threshold value. Additional data or information is then requested from these banks, in order to determine whether the breach of the threshold signals the appearance of a stress situation or potentially the existence of vulnerabilities created by the bank's business model that lead to a low level of unencumbered assets. On the other hand, if the breach of a threshold value appears to be temporary or unrelated to stress or particular weaknesses, it may be considered as a false alarm. If it is judged that the breach of a threshold value of the asset encumbrance indicator is not a false alarm, discussion is undertaken with the bank as to the changes that should be made in order to redress the situation.

1.2 Resolution

Institutional and legal framework

Regulation (EU) No. 806/2014[4], the SRM Regulation establishing the single resolution mechanism, entered fully into force on 1 January 2016. The SRM comprises the Single Resolution Board (SRB), all the national resolution authorities of the Member States participating in the banking union, the European Commission and the EU Council.

The practical consequence of the full entry into force of the SRM Regulation is that, since 1 January 2016, the SRB has had power to devise resolution plans and take resolution decisions concerning (i) institutions deemed significant in accordance with Article 6 of the SRM Regulation, (ii) institutions over which the ECB decides to exercise direct supervision, and (iii) cross-border groups. The national resolution authorities – in Belgium, the Bank's Resolution College – have the same powers in respect of institutions outside the SRB's sphere of competence.

The transposition of the BRRD into Belgian law was completed in 2016. First, the provisions on resolution financing were transposed by the Law of 27 June 2016[5], which made changes to the Banking Law by adding provisions on intra-group financial support, and which provides for

(1) Law of 25 April 2014 on the legal status and supervision of credit institutions and investment firms.
(2) National Bank of Belgium Regulation of 1 April 2014 concerning encumbered assets in connection with recovery plans.
(3) Communication NBB_2016_34 of 18 July 2016 "Recovery plans – Obligations concerning encumbered assets".
(4) 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.
(5) Law transposing miscellaneous provisions of 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, published in the *Moniteur belge/Belgisch Staatsblad* on 6 July 2016.

the setting up of a Belgian Resolution Fund via amendment of the Law of 28 December 2011 [1].

Next, since the autumn of 2016, Belgium has had recovery and resolution rules applicable to certain investment firms included in the Law of 25 October 2016 [2]. That piece of legislation amended the Banking Law so that certain investment firms – namely those required to hold paid-up capital of at least € 730 000 – would also be covered by the framework introduced by the BRRD.

On 23 November 2016, the European Commission adopted a legislative initiative aimed at harmonising the hierarchy of creditors applicable in the event of failure of a credit institution or investment firm [3]. That initiative follows a series of legislative amendments in recent months in a number of Member States, including Germany, France, Italy and Spain. Those amendments were intended to facilitate the implementation of the bail-in mechanism introduced by the BRRD in 2014. For that purpose, some of those national laws aim first to align the hierarchy prevailing in a creditors' arrangement procedure with the ranking for the assignment of losses to the various creditors of an institution, as defined in the BRRD. In addition, a new category of liabilities was created – liabilities subordinate to operational liabilities [4] – considered more appropriate for absorbing losses in the event of resolution. Finally, some of these changes to the law grant preference to certain operational liabilities for which the application of the bail-in mechanism appears more problematic at first sight.

On 23 November 2016, the European Commission also published a legislative initiative aimed at harmonising the application of the MREL and transposing into European law the minimum requirements concerning the TLAC resulting from the international standards developed by the FSB for global systemically important banks (G-SIBs).

Resolution plans

The BRRD requires a resolution plan to be developed for each European banking group. The preparation of a resolution plan is aimed at improving a group's resolvability. A banking group is considered resolvable under the Directive if the resolution authority can either liquidate all the group's constituent legal entities via normal insolvency proceedings, or resolve it by applying the various resolution tools and powers at its disposal while safeguarding the stability of the financial system and ensuring the continuity of the critical functions performed by the group. The BRRD requires resolvability to be demonstrated both in an idiosyncratic crisis specific to the banking group and in a systemic crisis situation which could threaten the stability of the entire financial system. If resolvability is unproven and if the resolution authority identifies major impediments to resolvability, it has powers which enable it to take preventive action to remove these impediments.

The SRM Regulation gives the SRB responsibility for preparing the resolution plans of significant credit institutions, cross-border credit institutions, and those subject to the ECB's direct supervision. Responsibility for drawing up the plans for other less significant institutions falls to the national resolution authorities.

Designing resolution plans is an iterative process which, depending on the complexity of the banking group, may extend over several years. Resolution plans are a new instrument for which the methodology is still being developed. In that connection, the SRB devised a sequential approach defining various stages in the preparation of resolution plans. In order to design a plan that fully satisfies the BRRD's requirements, the SRB begins by establishing a transitional resolution plan, which is then followed by a phase 2 resolution plan. The transitional resolution plan defines the basis of a resolution plan and the bases of the resolution strategy. The phase 2 resolution plan is a much more important document which, as well as containing a strategic analysis of the banking group, defines a resolution strategy, deals with the operational continuity of the group in resolution and the communication channels, and determines certain obstacles to the implementation of the resolution plan. It is not yet a plan that meets all the requirements of the BRRD. In particular, the plan does not define any MREL and does not list all the substantive impediments to resolvability. The subsequent development stages will be specified by the SRB in the coming months.

The SRB's resolution plans are drawn up by internal resolution teams comprising members of the SRB and representatives of national resolution authorities. During 2016, the Bank, as the national resolution authority, took part in developing three phase 2 resolution plans concerning significant institutions established in Belgium, and transitional resolution plans for two other significant institutions likewise established in Belgium. In addition, the Bank was involved in putting together resolution plans for eight major banking groups with subsidiaries in Belgium.

(1) Law of 28 December 2011 on the Resolution Fund, formerly the Law establishing a financial stability contribution.
(2) Law of 25 October 2016 on the status and supervision of investment firms and containing miscellaneous provisions, published in the Moniteur belge/Belgisch Staatsblad on 21 November 2016.
(3) Proposal for a Directive of the European Parliament and of the Council on amending Directive 2014/59/EU of the European Parliament and of the Council as regards the ranking of unsecured debt instruments in insolvency hierarchy.
(4) See the TLAC Term Sheet, i.e. the liabilities relating to the banking operations of an institution which, in the event of problems, may disrupt the institution's critical functions and lead to significant financial instability.

A crucial element of the resolution plans is the definition of the MREL. During 2016, neither the Bank nor the SRB determined the extent of that requirement in connection with the design of the phase 2 resolution plans or the transitional resolution plans. Nonetheless, for each group for which a phase 2 resolution plan was developed, the SRB indicated an informative consolidated target level, though that level was not binding, nor enforceable or challengeable. The level notified to each of the groups results from automatic application of the European Commission's Delegated Regulation of 23 May 2016 [(1)].

Resolution financing

The BRRD requires each Member State to establish a national resolution fund. That fund is financed by levying contributions from credit institutions and investment undertakings. It should reach a target level of at least 1 % of the total volume of deposits covered by no later than 31 December 2024.

The SRM Regulation established the Single Resolution Fund (SRF) in the banking union on 1 January 2016. It replaces the national resolution funds for credit institutions and investment undertakings covered by that Regulation. The fund must be created within eight years. 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. The SRB estimates the target level of the SRF at € 55 billion in 2023.

The SRB defines the annual target level of the SRF and calculates the contributions for each institution. The national resolution authorities work with the SRB at every stage in the process. More specifically, by no later than 31 January in each year, they collect the data necessary for the calculation, and they notify the institutions of the amounts of their contributions by no later than 1 May.

The method of calculating the SRF contributions is determined by a European Commission Delegated Regulation [(2)]. The smallest institutions pay a flat-rate contribution. A risk-adjusted calculation method is used to determine the contributions of larger institutions. Under the intergovernmental agreement on the transfer and mutualisation of the SRF contributions, one-eighth of the contributions levied in 2015 by the national resolution authorities is deducted annually from the amounts payable.

During 2016, the SRB levied a sum of € 277.6 million on the Belgian institutions liable for contributions, while in 2015 the sum collected was € 234.8 million. The institutions were able to pay 15 % of their contribution in the form of an irrevocable payment commitment guaranteed by cash collateral. The SRF has already collected a total of € 10.7 billion from institutions covered by the SRM Regulation.

For institutions not subject to the SRF, i.e. branches located in Belgium of credit institutions or investment undertakings of a third country, and Belgian investment firms not covered by the ECB's consolidated supervision of their parent company, the Law of 27 June 2016 contains rules on the creation of a national resolution fund financed by the levying of annual contributions. The Law specifies that the contribution and payment arrangements are determined by the Bank's Resolution College, and that the national resolution fund collects those contributions. The calculation methodology may be specified by a Royal Decree adopted on the recommendation of the Resolution College. In 2016, the Resolution College adopted a Circular specifying the calculation method applied for that year, and informed the national resolution fund of the amount of the contributions due from institutions not liable for contributions to the SRF. The annual target level for 2016 is just under € 400 000.

2. Insurance undertakings

2.1 Regulatory framework

There is no regime equivalent to the BRRD for insurance or reinsurance undertakings. Nonetheless, the Solvency II Law does contain measures comparable to the recovery measures. They are preventive measures (such as preparation of a recovery plan), recovery measures (such as submission of a recovery programme or a short-term financing plan), exceptional measures (such as the appointment of a special commissioner), erasure or revocation of licensing, periodic penalty payments or coercive measures.

In regard to resolution, apart from the measures that the King may, under certain conditions, take to safeguard the financial system, the Solvency II Law makes no provision for a resolution regime in the strict sense of the term (as an alternative to the bankruptcy regime).

Nevertheless, discussions – in which the Bank participated – took place in 2016 both at international level in

(1) Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities.

(2) 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.

the International Association of Insurance Supervisors (IAIS) and at European level in the European Insurance and Occupational Pensions Authority (EIOPA), to encourage the development in the insurance sector of a harmonised framework covering both recovery and resolution.

2.2 Implementation

While all insurance undertakings on the Belgian market met the statutory provisions of the Law of 9 July 1975, some of them were confronted by rules which they found difficult to comply with, either because of their particular risk profile or their lack of preparation (incorrect interpretation of some provisions) when applying the new Solvency II regime, or because the general low level of interest rates was more of a problem for them than for other insurers. In 2016, the Bank therefore imposed a recovery plan on four undertakings, and is overseeing the implementation of the plan.

For the rest, as the prudential supervisor of a large Belgian insurer forming part of a group classed as a globally systemically important insurer (G-SII), the Bank still takes part in the work of a Crisis Management Group (CMG). In 2016, the main activities of the CMG were: (i) the signing of a cooperation agreement to determine the tasks and responsibilities of the CMG members and decide the arrangements for cooperation within the group, (ii) validation of the Systemic Risk Management Plan, stating why the group in question is regarded as a G-SII and how it manages those systemic risks, (iii) approval of the group's 2016 recovery plan and the Liquidity Risk Management Plan, and (iv) preparation of an initial draft group resolution plan comprising a resolution strategy but no provisions on the resolvability assessment.

3. Financial market infrastructures

In 2015, the Bank had published a Circular clarifying the recovery plan requirements for financial market infrastructures (FMIs). It was based on the one previously published by the Bank concerning recovery plans for banks, and on guidelines concerning FMI recovery plans, published in October 2014 by the Committee on Payments and Market Infrastructures – International Organisation of Securities Commissions (CPMI-IOSCO). The main differences compared to the Circular on recovery plans for banks concern the "governance" and "strategic analysis" modules. In the FMI Circular, two modules were added, namely "structural weaknesses" and "links between FMIs", and there is the option of sharing information from the recovery plan of a cross-border FMI with other authorities concerned.

A revised version of the Circular was published during the year under review to take account of the guidelines which have since been issued by the EBA on the subject of recovery plan indicators. A recovery plan indicator is a threshold value indicating the point at which the FMI must check whether the recovery options under the plan should be implemented. The recovery plan must include indicators of capitalisation, liquidity, profitability and asset quality. Since the indicators imposed by the EBA do not all correspond to the business model of the FMIs, the latter are required to replace any irrelevant indicators.

During the year under review, the Bank analysed Euroclear Bank's recovery plan. Although the updated version of the Circular had not yet been published at the time, the analysis nevertheless took account of the EBA guidelines already applicable to recovery plan indicators.

In 2016, particular attention also focused on the resolution plan of The Bank of New York SA/NV, and especially the impact of the measures to improve resolvability (see chapter E in the section on "Prudential regulation and supervision" in this Report).

The Bank also takes part in the international discussions on the recovery and resolution plans of central counterparties (CCPs). On 28 November 2016, the European Commission published a proposal on the recovery and resolution of central counterparties. That proposal aims to (i) safeguard the continuity of the critical functions of the FMIs in the event of very serious financial stress, (ii) ensure financial stability, and (iii) avoid the need for governments to provide financial support. New international guidelines on the subject are expected during the course of 2017.