Report 2013

Prudential regulation and supervision

NationalBank OF BELGIUM

Eurosystem

B. Prudential regulation

1. Introduction

During the year under review, work continued on the reform of the prudential regulatory framework. The measures were transposed into Belgian and European law on the basis of the guidelines established by the international institutions.

For the banking sector, this concerned more specifically the publication of CRD IV and CRR, which apply from 1 January 2014, and the proposals for a Regulation on the single resolution mechanism and a Directive on the recovery and resolution of banks. These European provisions need to be transposed into Belgian law, hence the new banking law. Its scope is very broad: as well as transposing CRD IV, CRR and the recovery and resolution provisions, it covers structural reforms and remuneration policy. These various points are considered in more detail in section 2 of this chapter.

In regard to the insurance sector, the changes concerning prudential regulation stipulated in the Solvency II Directive (1) were postponed again. However, transitional measures were adopted under the Quick Fix I and II Directives, so that some provisions of the Regulation could already be implemented. In addition, the Solvency II Directive required amendment, and that was done by the Omnibus II Directive. Owing to the delay in implementing Solvency II, it was not possible to finalise a predraft Belgian law during the year under review. In order to prepare firms for the new supervision regulations, the Bank decided to comply with and supplement the EIOPA guidelines. Furthermore, measures were adopted at Belgian level concerning interest rate risk provisions (flashing-light provisions), while the Bank submitted predrafts to the government on the acceptance of publicly guaranteed loans as covering assets and the system of exemption for local insurance companies. Section 3 of this chapter looks at these subjects in more detail.

For market infrastructures, the standards for central counterparties were laid down in the European Market Infrastructure Regulation (EMIR) (2) and the Implementing Regulations. In addition, further work was done on the European legislation on central securities depositories, the recovery and resolution of market infrastructures, and payment services. The Bank kept a close watch on all these activities, as discussed in section 4 of this chapter.

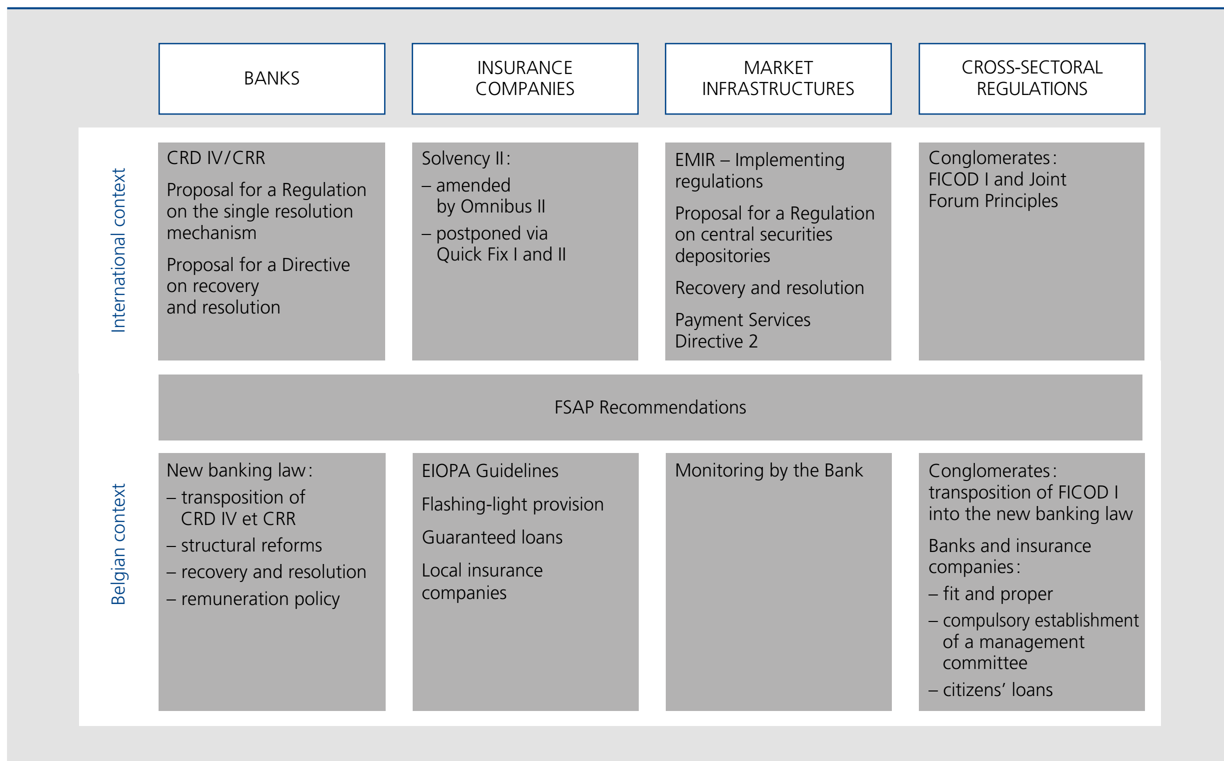
Progress was also made at cross-sectoral level, starting with the transposition via the new banking law of the Financial Conglomerates Directive (FICOD I) (3) and the Joint Forum Principles. In regard to the banking and insurance sector, the Bank paid particular attention to the fit and proper character of the management of financial institutions. From now on, under the banking law and the alignment of the insurance supervision law, it is compulsory to set up a management committee. Finally, in regard to "citizens' loans", the Bank has the task of checking whether the use of the money raised by means of these contracts conforms to the legal rules. These cross-sectoral aspects are explained in section 5 of this chapter.

(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.

(2) Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

(3) Directive 2011/89/EU of the European Parliament and of the Council of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate.

CHART 5 REFORMS OF THE PRUDENTIAL REGULATION FRAMEWORK IN 2013 (1)



Source: NBB
(1) The legislation mentioned in the "international context" was in many cases already finalised previously but had an impact on the "Belgian context" during the year under review.

2. Banks

2.1 Transposition of Basel III into Community law – CRD IV/CRR

The lengthy process of transposing into Community law the Basel Committee proposals known as Basel III, on which work had begun in 2011, culminated in the June 2013 publication of CRD IV and CRR. This Directive and the Regulation applied on 1 January 2014 (1).

The Directive introduces new organisational provisions which require the establishment, within the statutory board of directors, of an audit committee, an appointments committee, a risk committee and a remuneration committee. In regard to the last two, the risk committee is intended to enable the statutory board of directors to determine the institution's risk strategy and risk tolerance with full knowledge of the facts, and to keep a close watch to ensure that the effective management of the institution implements and respects these two parameters. The remuneration committee has to ensure that the incentives created by the remuneration system, including the promotion system, are not such as to lead to excessive risk-taking in the institution or behaviour motivated by interests other than those of the institution and its stakeholders. To that end, the Directive specifically defines the policy rules applicable to the variable components of remuneration. In particular, except in special cases, it limits the variable component of remuneration to 100 % of the fixed component.

The new European Regulation defines the minimum solvency and liquidity requirements to be respected by all credit institutions and investment firms in Europe. Those requirements are equivalent to the ones proposed by the Basel Committee and approved by the Group of Governors and Heads of Supervision, and later by the G20 in November 2010 (2). Long transitional periods are specified for both categories of requirements, so that the new regulations can be phased in gradually, thus moderating their economic impact.

Solvency requirements

In regard to solvency, the EU Regulation introduces a leverage ratio. That ratio defines the minimum amount of own funds in relation to the total volume of assets, in order to ensure that a rapid rise in lending to counterparties with a low risk weighting does not lead to an excessive increase in the total debt ratio or leverage. It also sets aside any inconsistencies in the calculation of risk-weighted assets. While the Basel Committee proposed a level of 3 %, the Regulation only introduced the leverage ratio as an observation ratio up to 1 January 2018. In the light of the lessons derived from this observation period regarding the impact on credit institutions' business, the Commission can then make this ratio mandatory via a legislative proposal which will have to be approved by the Council and by the European Parliament.

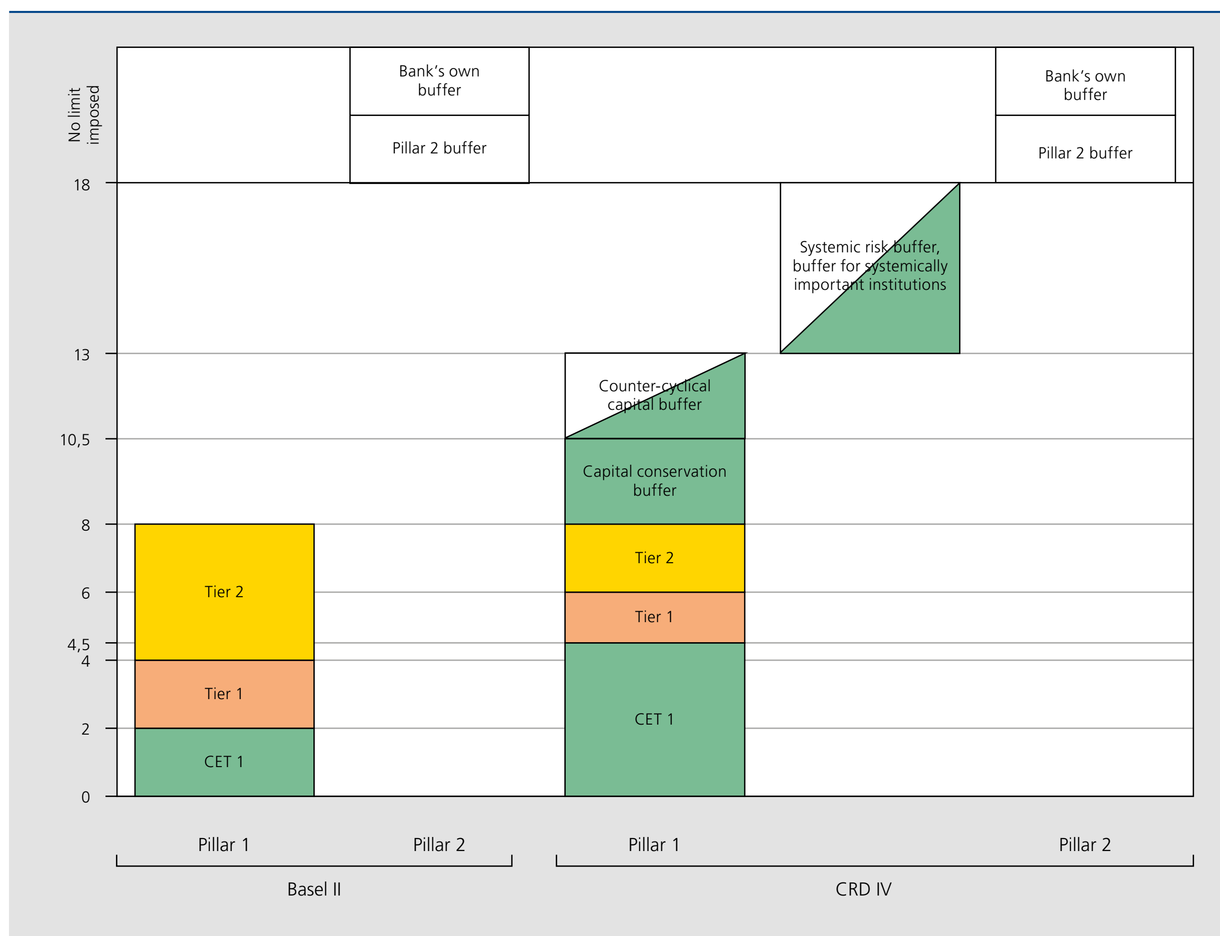
The Regulation also modifies the minimum solvency ratios expressed as percentages of the own funds to be held in relation to the weighted risk volume. Compared to the previous rules, the percentages to be respected have been raised and the definitions of both own funds and the weighted risk volume for specific risks have been tightened up. As for the percentages, the new minimum requirements raise the solvency ratio from 2 % to 4.5 % for core elements of own funds (common equity Tier 1 – CET 1), from 4 % to 6 % for Tier 1 and to 8 % in terms of total capital.

(1) CRD IV and CRR came into force on 17 July 2013 and on 28 June 2013 respectively. CRD IV had to be transposed into the national law of the Member States by 31 December 2013. CRR applies from 1 January 2014.

(2) See Report 2011, "Financial stability and prudential supervision", p. 50 to 54.

CHART 6 MINIMUM REQUIREMENTS FOR REGULATORY CAPITAL UNDER BASEL II AND CRD IV AT THE END OF THE TRANSITION PERIOD (1)

(in % of the risk-weighted assets)



Source : Basel Committee.
(1) A completed box indicates an obligation, a blank box indicates an option.

In the definition of own funds used for these ratios, the emphasis is on the core elements of own funds, which essentially comprise the capital represented by the ordinary shares and the reserves. In addition, the deductions and adjustments to own funds, e.g. in respect of goodwill or holdings in other financial institutions, were harmonised and are now applied to these core elements of the own funds. In forming their Tier 1 equity, institutions can always include hybrid debt instruments in addition to the common equity elements, so long as they are perpetual, offer total flexibility on payment and remuneration, and can be used to cover losses if necessary. Subordinated instruments with a minimum maturity of five years can continue to be taken into account as additional or Tier 2 elements in calculating the total own funds.

Turning to the risk-weighted exposure, the Regulation strengthens the capital requirements for credit risks in the case of derivatives business by imposing a capital charge for potential losses of market value resulting from downgrading of the counterparty's credit rating. Conversely, to attenuate the risk that higher solvency standards could affect lending to SMEs, the Regulation permits a 24 % reduction in the credit risk requirements for loans to SMEs, subject to certain conditions. These lower requirements will be reviewed in 2017 on the basis of a report to be drawn up by the EBA on the situation regarding lending to SMEs and the risks associated with that business.

The CRD IV Directive introduces an additional provision to lessen the pro-cyclical effect of the solvency requirements. As well as the minimum required by the Regulation, credit institutions will have to gradually build up a 2.5 % common equity buffer, known as the capital conservation buffer. In the event of a crisis, the supervisory authorities may decide to reduce the level of that buffer in order to

enable the banking sector to continue financing the economy; conversely, in the event of a credit boom, they can increase the level with an extra capital buffer known as the counter-cyclical capital buffer. If a credit institution has insufficient own funds to meet the minimum requirement and form the required buffers, the supervisory authority may impose restrictions on the payment of dividends to shareholders and on variable remuneration.

The EBA was given the task of drawing up the technical measures to ensure uniform application of these rules in Europe. In practice, that means that the Member States will have less freedom than before to impose more stringent standards on their entire banking sector. However, the Regulation and the Directive do offer the Member States some flexibility for increasing the regulatory requirements, so long as that is justified either by macroprudential risks or by structural differences between the various national financial markets.

If heightened systemic risks pose a threat to the financial sector's stability, the European regulation permits the Member States to increase the overall capital requirements, impose targeted additional requirements, e.g. on the financial sector or the real estate sector, or impose stricter rules on risk concentrations [1]. However, these measures must be justified in the light of the increased risks. In certain cases the Council may oppose a measure taken by the Member State, particularly if the ESRB, the EBA or the Commission considers that the stated justifications are not sufficiently well-founded, that the proposed measure is inappropriate, or if it has an excessively adverse impact on the functioning of the Single Market.

The Member States can also impose an extra capital buffer to take account of the structural systemic risks in their financial sector. To cater for any adverse effects of that measure on the other Member States, a notification and authorisation procedure was introduced, obliging national authorities to notify the European Commission, the EBA and the ESRB one month in advance, stating the reasons for their decision. The EBA and the ESRB are responsible for assessing whether the decision to impose such a surcharge might have excessively harmful consequences for the financial system of other Member States or for the functioning of the single market. From 2016, the Commission may also automatically oppose any systemic risk requirement in excess of 5 % of the exposure.

Finally, in accordance with the international standards, the Directive also allows the Member States to impose an extra capital buffer on institutions deemed systemically important at global or local level. That additional requirement may range between 1 % and 3.5 % of the weighted exposure and must be met by the common equity.

As regards the practical application of this new legislation to Belgian credit institutions and investment firms, the Bank prepared its own draft regulation during the year under review. This draft sets out, among other things, the rules on exercising the options left open by the European legislation and the rules on application of the transitional measures.

As far as the rules on exercising the options are concerned, the Bank decided in particular to maintain its policy on the treatment of holdings in insurance companies, accepting that these are not deducted from the own funds if they are held by a mixed financial holding company. In contrast, holdings by credit institutions or investment firms must be deducted from the own funds. The Bank also decided to maintain its policy on risk concentration by limiting the exposures of Belgian subsidiaries of foreign institutions to their group to 100 % of their own funds.

In addition, the Bank adopted a set of measures to enable credit institutions to adjust the level of their own funds gradually to the new regulations. For example, during a transitional period, it authorised them to retain in their own funds existing capital instruments which do not meet the eligibility criteria under the new regulations. If they are not redeemed in the meantime, these instruments will be gradually excluded from the own funds over a ten-year period. New deductions from the own funds, mainly those relating to unrealised losses on the investment portfolio recorded at market value and deferred taxation, will be phased in over a five-year period.

Liquidity standards

Published by the Basel Committee on Banking Supervision in December 2010, the Basel III package includes for the first time, in addition to solvency requirements, two harmonised international liquidity standards: the liquidity coverage ratio (LCR), which requires banks to hold sufficient buffers in the form of liquid assets to withstand a serious liquidity crisis independently for one month, and the net stable funding ratio (NSFR), which focuses on a robust structural liquidity position and encourages institutions to finance their illiquid assets with relatively stable sources of funding, such as long-term funds, capital and deposits of households and SMEs. At the beginning of 2013, the Basel Committee published a finalised version of the LCR

(1) See chapter A, section 4, of the part on "Prudential regulation and supervision" of the Report.

calibration. During the year under review, the Committee continued its analysis of the interactions between the LCR and monetary policy, the transparency requirements for the LCR and the final calibration of the second ratio, the NSFR.

Under the terms of the CRR, the first harmonised liquidity ratio, the LCR, is to apply to all credit institutions and financial holding companies in Europe from 1 January 2015, both in regard to individual legal entities and at the highest consolidation level in Europe. The LCR will be phased in as a regulatory standard, starting with a minimum requirement of 60 % at the beginning of 2015, raised by 10 % a year in 2016 and 2017, and by 20 % at the beginning of 2018 to bring the ratio up to 100 %. The CRR stipulates that the European Commission will specify the final details of the European LCR by no later than the end of June 2014. The EBA was also requested to devise various technical standards and guidelines defining certain aspects of the LCR. On the subject of the NSFR, the CRR states that the European Commission may prepare a legislative proposal by the end of 2016, introducing this ratio as a regulatory standard. Finally, the CRR provides for the establishment of unified liquidity reporting for all credit institutions from 2014.

With effect from 2015, liquidity regulation and reporting in Belgium must therefore be adapted or replaced in accordance with the European single rulebook specified by the CRD IV and the CRR. However, as the local supervisory authority, the National Bank retains some discretion over the transition from the national liquidity ratios to the LCR, even in the case of significant banks subject to the direct supervision of the SSM, until such time as the LCR has been fully phased in by the CRR. The Bank's liquidity rules have already been applying quantitative liquidity standards comparable to the LCR since 2011. The Bank therefore intends to make sure that credit institutions and financial holding companies under Belgian law continue to hold sufficient liquidity reserves at the time of transition from the Bank's ratio to the LCR, in order to avoid any "cliff effects" [1] due to the phased introduction. The CRR explicitly allows the national authorities to impose stricter requirements until the LCR has been introduced in full. The Bank therefore intends to phase in the European LCR 100 % from 1 January 2015. After that date, the Belgian regulations on quantitative liquidity standards and liquidity reporting will therefore cease to apply in the case of all Belgian credit institutions and financial holding companies. The Bank explained these strategic decisions in a communication to the institutions concerned. In a later phase, these plans will be put into effect via adjustments to the relevant regulations.

In preparation for the introduction of these international standards as liquidity requirements for Belgian banks, a sample of institutions are already submitting quarterly reports to the supervisory authority on their position. The EBA then uses that information to draw up various technical standards and guidelines defining certain aspects of the LCR. From 2014, the said introduction of European prudential liquidity reporting will require all credit institutions and financial holding companies to submit reports on the standards laid down by Basel III. Apart from the reporting on these two future liquidity standards, the EBA has also developed additional harmonised reporting on other aspects of the banks' liquidity position, notably the maturity of the assets and liabilities and the concentration of funding per counterparty and per product. This additional reporting will enable the supervisors to gain a fuller picture of the position of institutions and to monitor it more effectively.

2.2 Transposition of the CRD IV and the CRR into Belgian law

The CRD IV Directive and the CRR Regulation were adopted on 26 June 2013. They implement the recommendations of the Basel Committee on Banking Supervision, particularly the "Basel III" provisions [2]. In view of the extremely short time allowed for transposing the CRD IV and the CRR into Belgian law, the Bank made a major contribution to the work of transposition conducted under the direction of the Minister of Finance. That work was incorporated in a fundamental revision of the Banking Law of 22 March 1993 [3] [4]. The entry into force of the new banking law is to be accompanied by an important regulatory section designed in particular to implement various options that the CRR left to the discretion of the Member States and national competent authorities.

The transposition also affords the opportunity for clarifying the scope of certain provisions in line with the IMF's Financial Sector Assessment Programme (FSAP) [5] and the Basel Committee's recommendations.

CRD IV contains numerous provisions on governance [6]. Those provisions were reclassified in order to bring

(1) Avoidance of cliff effects when phasing in the LCR means the need to ensure that banks already respecting the 100 % standard do not temporarily reduce their liquidity buffers because the LCR is being phased in and only stipulates a ratio of 60 % in 2015.
(2) See chapter B, section 2.1, of the part on "Prudential regulation and supervision" of the Report.
(3) Law of 22 March 1993 on the status and supervision of credit institutions.
(4) The changes concerning investment firms, especially brokerage firms, will form the subject of a separate draft law.
(5) See chapter C, section 1.1, of the part on "Prudential regulation and supervision".
(6) See chapter B, section 2.1, of the part on "Prudential regulation and supervision".

together in the new law all the measures concerning the governance structure as such. Those measures are described in Box 2.

While there are no other substantial changes concerning access to the banking business, the new law includes various additional modifications derived essentially from CRD IV, intended to regulate the pursuit of the business. This mainly concerns risk management and remuneration policy [(1)]. A separate chapter devoted to specific operations (mergers and assignments, issuance of covered bonds, pursuit of activities abroad, etc.), groups together some subjects already covered by the Banking Law of 22 March 1993, with the addition of strategic decisions, originally introduced for systemically important institutions in the Bank's Organic Law.

The chapter of the new banking law concerning regulatory standards and obligations is supplemented by the new provisions on additional capital buffers. Those buffers must consist of top-quality own funds, as they are meant to be the first to absorb any losses that the credit institution incurs in its activities. This concerns the capital conservation buffer, the counter-cyclical capital buffer, the capital buffer for systemically important institutions and the capital buffer for macroprudential risk. These new requirements are derived directly from CRD IV.

Compliance with these additional requirements on the formation of capital buffers is assured by the innovative provisions imposing restrictions on the payment of dividends. The new banking law stipulates that so long as the institution fails to satisfy its additional CET1 requirement, it may not pay out any dividends that result in a reduction in the common equity Tier 1 or CET1. In such cases, the priority must be to rebuild the highest quality core equity.

However, in accordance with CRD IV, the new banking law does permit some derogations from this principle of a ban on any dividend payments. Those derogations, which are subject to conditions that vary according to the size of the reduction in the safety buffers, thus enable credit institutions to rebuild their capital gradually by earmarking part of the profits for restoration of the buffer first before any discretionary distribution (dividends, share repurchases and variable bonuses, etc.). CRD IV circumscribes the progressive character of the capital

(1) See chapter B, section 2.5, of the part on "Prudential regulation and supervision".

Box 2 – Provisions on governance in the new banking law

CRD IV devotes much attention to the statutory board of directors, specifying its role and responsibilities in many areas. First, the statutory board of directors is expected to define the business strategy and objectives, including the institution's risk tolerance. Next, in order to strengthen the supervisory and monitoring role of the statutory board of directors, one of the key aims of CRD IV, it is necessary to make a clear distinction within that body between the supervision and monitoring functions relating to the institution on the one side and those relating to the effective management on the other.

That is why the new banking law makes it mandatory to establish a management committee within the statutory board of directors of credit institutions [(1)]. This presupposes that the non-executive board members, who are therefore not members of the management committee, form the majority on the statutory board of directors, that all executive board members, and only those members, form part of the management committee, and finally, that the chairman of the statutory board of directors is not the same person as the management committee chairman.

The supervisory authority will have a power of derogation which may lead to some relaxation of the requirements in the case of smaller organisations, in accordance with the principle of proportionality for which CRD IV makes express provision.

(1) See also section 5.2 of this chapter.

In order to enhance the effectiveness of the supervision and monitoring of the activities, operation and risk profile of significant institutions by the statutory board of directors, CRD IV requires four special committees to be set up within that board. Apart from the audit committee and the remuneration committee already stipulated by the Law of 22 March 1993, the new banking law requires the creation of a risk committee and a nomination committee. These committees are responsible for preparing the decisions of the statutory board of directors on their respective subjects. Only the non-executive members of the statutory board of directors – who are not involved in the effective management of the institution – may form part of these committees, which are intended to reinforce the supervisory function of the statutory board of directors.

The establishment of a risk committee within the statutory board of directors is one of the key advances of CRD IV. That is why the latter, and hence the new banking law, stipulate that each member of the risk committee shall individually have a full understanding of the subjects handled by the said risk committee. The statutory board of directors can then act with full knowledge of the facts to determine the risk strategy and risk tolerance appropriate to the institution, notably in regard to proprietary trading activities (see section 2.3 of this chapter), and closely supervise the implementation and compliance by the effective management of the institution.

The professionalisation of the statutory management bodies is to be evident not only in the profiles of their members but also in their degree of commitment and independence in the exercise of their mandate. In this connection, the nomination committee assesses the level of knowledge, commitment, availability and independent mindedness required for the statutory board of directors as a whole and for each of its members according to the characteristics of the credit institution.

At the instigation of the European Parliament, CRD IV also includes a specific provision aimed at encouraging diversity, more particularly the representation of women on the statutory management bodies. That provision was transposed into the new banking law.

As regards the operational organisation, it should be noted that the Law of 22 March 1993 contained very few specific provisions on the operational independent control functions of internal audit, risk management and compliance, which should not be confused with the aforesaid committees dealing with some of these subjects within the statutory board of directors. The relationship between the commercial and business units and the independent control functions is sometimes defined as the three-line defence model of a credit institution:

- the commercial and business units (including the front office) form the institution's first line of defence, which has to identify the risks of each transaction and adhere to the set procedures and limits;
- the second line of defence comprises the oversight functions (sometimes also called support functions), namely the risk management function and the compliance function, responsible for ensuring that the risks are identified and managed by the commercial and business units (and the front office) in accordance with the set rules and procedures;
- the third line of defence is the internal audit which, among other things, ensures respect for the procedures by the first and second lines of defence.

The new banking law defines the necessary independence of these three functions, their powers and the arrangements for remuneration of the person in charge and the staff assigned to the performance of the functions. It should be noted that, in practice, the new rules have largely been anticipated.

rebuilding thus defined, and imposes the calculation rules to be applied in order to determine how much institutions must retain and how much they can pay out; this is known as the "maximum distributable amount".

The provisions on the oversight of credit institutions incorporate a new chapter on the prudential supervision process which transposes CRD IV, while corresponding to current good practice. The section on group oversight (oversight on a consolidated basis and

supplementary supervision of conglomerates) forms a coherent whole, containing the provisions of the EU legislation on supplementary supervision of financial conglomerates [1], the provisions of the Banking Law of 22 March 1993, and those of the Royal Decrees of 12 August 1994 and 21 November 2005 [2] [3].

As for the recovery measures applicable in cases where an institution fails to comply with the prudential laws or regulations, the banking law adds new, binding measures to the Banking Law of 22 March 1993, formulated on the basis of CRD IV, plus the possibility of implementing a recovery plan. In line with CRD IV, the new banking law in fact provides for two innovations.

The aim of the first innovation is that measures can be taken to remedy a failure before it actually occurs. If a supervisory authority has information indicating that, within the next twelve months, a credit institution is likely to cease functioning, in accordance with the current legislation on supervision, it can thus already require certain measures to be taken within a specified period. The second innovation consists in the option for the supervisory authority to impose tougher requirements on a credit institution if it identifies a failure or a recognised risk of failure, even if the authority has already set a recovery deadline. In that situation, the credit institution may be made subject to additional or specific requirements relating to solvency, liquidity, risk concentration, valuation, reporting or disclosure. The supervisory authority may also impose more binding measures on the rebuilding of the capital, in relation to dividend distribution or any payment to shareholders and/or holders of equity instruments, or concerning variable remuneration. These binding measures will be lifted when the supervisory authority finds that the institution has rectified the situation within the specified time.

Except for the provisions resulting from the changes inherent in the transposition of CRD IV, there is nothing fundamentally new about the provisions relating to penalty payments, other coercive measures and sanctions. The new banking law distinguishes between penalty payments and administrative sanctions, in view of their differing nature and purpose.

(1) See chapter B, section 5.1, of the part on "Prudential regulation and supervision".
(2) Royal Decree of 12 August 1994 on the supervision on a consolidated basis of credit institutions, investment firms and investment fund management companies.
(3) Royal Decree of 21 November 2005 organising the supplementary supervision of credit institutions, insurance companies, reinsurance companies, investment firms and investment fund management companies forming part of a financial services group, and amending the Royal Decree of 22 February 1991 containing general rules on the supervision of insurance companies and the Royal Decree of 12 August 1994 on the supervision on a consolidated basis of credit institutions.
(4) See chapter A, section 2, of the part on "Prudential regulation and supervision".

Finally, the new banking law includes amending provisions to bring it into line with the changes in European law, particularly the ECB's new powers in the prudential supervision sphere [4].

2.3 Structural reforms

In July 2013, the Bank published its final report on structural banking reforms in Belgium, following the publication of its interim report in June 2012. When the Belgian government asked the Bank to analyse the question of structural reforms, two countries had announced their intention to implement such reforms in the banking sector, namely the United States, by means of the Volcker rule, and the United Kingdom, with the Vickers reforms. In October 2012 an ad-hoc group of experts chaired by Erkki Liikanen and appointed by the European Commission published a report containing recommendations on structural banking reforms in Europe. The above examples provided either for a ban on proprietary trading (i.e. activities which do not meet the needs of customers) or the separation of certain types of trading activities into distinct entities, in that case with a choice between total compartmentalisation or partial ring-fencing (for activities above a certain threshold).

The current emphasis on structural reforms was prompted by the significant role played by the banks' proprietary trading – very often involving complex financial products – in exacerbating the recent financial crisis. Although trading activities undeniably entail a high degree of risk, it must also be remembered that they are heterogeneous: some are riskier than others, and some are better for the real economy than others. Trading activities are varied by nature: they may concern trading for own account, financial services for customers in which the bank acts as counterparty in transactions relating, for example, to derivatives that a customer wishes to buy or sell, market-maker activities – notably on government bond markets – where the bank, as an intermediary, ensures sufficient liquidity for the market to operate smoothly, the provision of issue guarantees, and transactions intended to hedge the banks' own risk positions resulting from its "traditional" banking business.

Unfortunately, it is quite difficult in practice to distinguish between proprietary trading and other trading activities. For instance, the characteristics of proprietary trading are similar to those of market-making and certain hedging activities. In these last two cases, the banking entity acts as the counterparty in negotiating the underlying position and only maintains its position for a limited period. Moreover, these positions, even if held only temporarily,

may also generate profits or losses as a result of price fluctuations. Owing to these similarities, the characteristics of a transaction are not sufficient in themselves to determine whether or not the trading is taking place for own account. Instead, it is the purpose of the transaction and the intention of the trader that are decisive.

This problem of distinguishing between proprietary trading and other forms of dealing with similar characteristics explains some of the differences between the multiple proposals currently on the table concerning structural banking reforms. Thus, the Liikanen group opted to recommend separation of both proprietary trading and the market-making activities of deposit banks in order to avoid the lack of clarity that the separate definition of the two types of activity would create. In the United States, where the Volcker rule only requires the separation of proprietary trading, the authorities have spent over two years preparing regulations to implement that rule.

Apart from the problems relating to the distinction between proprietary trading and other trading activities, the aims of the structural banking reforms are numerous and difficult to implement. Those aims include: eliminating any implicit subsidy resulting from the deposit guarantee for trading activities, protecting retail activities from contagion by risk-trading activities, reducing risk-taking, and limiting any risk of taxpayers having to bear the cost of a bankruptcy. In view of these numerous problems, the Bank opted for an overall approach in its report, making policy recommendations in such varied spheres as recovery and resolution frameworks, trading activities proper, the tax treatment of savings, and depositor protection. This set of potential measures offers various lines of defence in relation to the challenge of achieving the stated objectives of the structural reforms.

Recommendations on proprietary trading

Two recommendations in the Bank's final report concern trading activities, and get right to the heart of the problems connected with structural banking reforms. The first recommendation, which is based on the interim report, concerns the application of capital surcharges to trading activities above a certain threshold. The aim is to discourage institutions from engaging in excessive trading activities and to ensure that these trading activities do not create a serious obstacle if the bank should require resolution. The second recommendation concerns requiring banks to transfer their proprietary trading activities above a certain threshold to a separate entity which is banned from accepting deposits. Strict limits would be imposed on intra-group positions between the deposit bank and this trading entity.

For the capital surcharges, two indicators – one based on risk and the other not – will be used to determine the thresholds beyond which the banks will be subject to a surcharge. The concept of a non-risk-based indicator is comparable to one of the Liikanen group proposals for providing a back stop in addition to the risk-weighted capital requirements, to protect against inadequate capital requirements for market risk as a result of model risks and measurement errors. The Bank's non-risk-based indicator puts the threshold for the ratio between trading assets and total assets at 15 %.

The risk-based indicator used to determine the capital surcharge will be based on the amount of the capital requirements for market risk as a percentage of the total capital requirements. Although the requirements for market risk apply to the bank's trading portfolio positions and are therefore a good risk-based indicator for trading positions, the requirements for market risk also have to be calculated for all exchange rate risks. Since in practice a large proportion of foreign exchange positions result from the hedging of exposures in the banking book, the proportion of the requirements for market risk resulting from foreign exchange positions is deducted from the risk-based indicator. Expressed as a percentage of the total capital requirements, the threshold determined by the risk-based indicator for the total amount of the capital requirements for market risk, after deduction of the requirements for market risk resulting from the foreign exchange risk, comes to 10 %.

If the non-risk-based indicator triggers a capital surcharge for trading activities, the amount of the surcharge will be equal to 100 % of the volume of trading activities above the threshold of 15 % of the total assets. If the risk-based indicator triggers a capital surcharge, the amount of the surcharge will be equal to three times the amount by which the capital requirements for market risk exceed the threshold of 10 % of the total capital requirements. If both indicators are triggered, the amount of the surcharge will be equal to the higher of the surcharges implied by either indicator.

Table 2 shows the average values of the two indicators for the four largest Belgian banks. It is evident that the average of the two indicators would have exceeded the thresholds in 2008, although there are significant differences between the individual values for the various banks. The table also shows that the values of the two indicators have fallen over time, suggesting that trading activities declined in the wake of the crisis.

Another recommendation in the Bank's final report is that proprietary trading activities above a certain capital threshold should be separated from deposit banks. The Bank proposes imposing such ring-fencing if the capital requirements for proprietary trading activities as defined exceed a specified threshold. The Bank has yet to put forward a proposed figure for that threshold, but it must not exceed a percentage to be set at between 0 % and 2.5 % of the capital. That margin offers some flexibility in determining the exact threshold ; at this stage, that is necessary in view of the problem of defining proprietary trading and distinguishing it from other trading activities. That flexibility also appears appropriate because no other country has adopted a similar rule.

Rules to be laid down in a separate regulation will define proprietary trading as all the residual activities which cannot be placed in other categories, such as market-making activities by official market-makers, transactions made at the request of customers and adequately hedged, and transactions relating to cash management or asset and liability management. Since there are no clear definitions of market-making or customer services, the exact details of the definition of these categories in the new banking law and the implementing regulations will play a significant role in determining the amounts of the banks' trading activities which will be classed as proprietary trading.

Both the measures proposed in relation to trading activities are innovative, and Belgium will be the first country to implement rules of this type. In addition, the Bank considers that these two policies are complementary. On the one hand, as trading activities are generally very risky, the surcharge should prevent banks engaging in an excessive volume of trading. Also, proprietary trading which is not clearly of benefit to the real economy should not form a significant percentage of the banks' trading activities.

Other recommendations

The bank recovery and resolution sphere forms the subject of three recommendations which also figured in the interim report. The first recommendation prescribes the preparation of recovery and resolution plans for all domestic systemically important banks (D-SIBs). In that respect, the Bank has already started preparing and evaluating recovery plans for eight Belgian D-SIBs (section 2.4, of this chapter).

The second recommendation advocates more effective regulatory and legal practices for launching resolution procedures in the event of credit institutions failing. For example, that recommendation suggests clarifying the NBB's role as a resolution authority. That point is now included in the new banking law which provides for the creation of an independent resolution authority at the Bank.

TABLE 2 VALUES OF THE NON-RISK-BASED INDICATOR AND THE RISK-BASED INDICATOR FOR THE FOUR LARGEST BELGIAN BANKS

(in %)

	End		Q1
	2012	2010	2008
Non-risk-based indicator	12.3	15.3	21.4
Risk-based indicator	5.2	8.8 (1)	13.9 (1)

Source: NBB.
(1) Estimated on the basis of the Basel 2.5 rules for capital requirements for market risks.

The third recommendation, in line with the requirement that all strategic decisions by D-SIBs must be submitted for the Bank's prior approval, concerns a broad definition of strategic decisions. That definition includes any change in the bank's operations or activities which could affect its resolvability. This recommendation has now been implemented in the Bank's prudential practices.

As for the other recommendations in the final report, the interim report had drawn attention to the high level of savings in Belgium, in conjunction with the key role – due partly to tax concessions – of bank intermediation for these savings. In view of the possible inefficiencies that could result, the Bank recommended making the subsidy for this type of savings instrument more neutral, in order to diversify the channels through which savings are allocated to investment in the real economy. The suggestion is that any extension to other instruments of the tax exemption for income from savings deposits should also apply to long-term instruments in order to alleviate the long-term funding constraints for businesses, and SMEs in particular, and to promote long-term saving (1). However, any abolition of the tax exemption for income from savings deposits should be phased in over a sufficiently long period in order to minimise the disruption for financial institutions and the financial system.

The last subject addressed in the final report concerns depositor protection. Policies aimed at protecting depositors are designed to increase the likelihood that balance sheet

(1) In any case, the tax exemptions on savings products must conform to the European rules, which prohibit any discrimination in favour of funds invested with financial institutions based in Belgium.

assets will be sufficient to cover the liabilities relating to deposits in the event of a bankruptcy, thus reducing the need for intervention by deposit guarantee systems or taxpayers. In that respect, the report recommends introducing a rule giving depositors priority in the creditor reimbursement ranking in the event of a bank failure. The recommended rule would imply that all deposits eligible for deposit protection would be repaid before unsecured creditors. The new banking law contains such a provision. The final report also recommends that banks should maintain a minimum amount of own funds or liabilities eligible for a bail-in, so as to avoid having to use taxpayers' money in the event of a bank failure.

2.4 Recovery and resolution

Agreement was reached in December of the year under review on the proposal for a Directive establishing a framework for recovery and resolution [1]. The Directive covers the whole sequence of crisis management, from preparation to resolution and financing. It applies to credit institutions and to some investment firms.

In order to improve the crisis management preparations, the Directive provides for the drafting of recovery and resolution plans. The major problems confronting some financial institutions since 2008 have shown that the time factor played a key role in the management of a financial crisis. Complex solutions have to be evaluated and implemented very swiftly, both by the struggling institution and by the government. However, some solutions should be capable of being assessed before a crisis erupts, in order to speed up the response by financial institutions and the government.

Such plans make it possible to explore the various potentially available crisis management options. As a result of these preparations, the obstacles to an orderly resolution can be identified and reduced during a non-crisis phase. The recovery plan identifies in particular the measures that a credit institution can take when facing a serious crisis. The aim of those measures is to restore the financial health of the institution that implements them. Conversely, the resolution plan identifies the critical economic functions so that, in a crisis, it is possible to proceed with an orderly resolution, minimising the cost to taxpayers in the event of public intervention. Moreover, the resolution plan tests the authorities' ability to use the various resolution instruments available to them.

For the purpose of drawing up these plans, the Directive specifies that resolution authorities should be able to take measures to reduce or remove obstacles to resolvability. Those powers include the option of requiring the institution to conclude service agreements to cover the provision of critical economic functions or services, to limit its maximum individual and aggregate exposures, to divest specific assets and to change its legal or operational structures so as to reduce complexity in order to permit the separation of critical functions from other functions in the event of resolution.

The Directive also introduces a new instrument : intra-group financial support. This is a mutual agreement setting out the arrangements for liquidity support within a group in the event of a crisis. Such an agreement is voluntary in that a group is not obliged to conclude one and, if it does so, not all the group companies need necessarily be parties to the agreement.

In addition, the Directive provides for extension and harmonisation of the early intervention powers and resolution instruments. The early intervention powers include the possibility for the supervisory authority to appoint a special manager, to require the institution to implement the measures set out in its recovery plan, to convene a shareholders' meeting and to require the institution to negotiate a debt restructuring plan with its creditors.

Furthermore, the Directive requires the Member States to designate a resolution authority whose powers include the use of the resolution instruments. These must be applied once an institution faces three conditions simultaneously. First, it must be failing or likely to fail. Second, there is no reasonable prospect that any alternative private sector or supervisory action would prevent the failure of the institution within a reasonable timeframe. Third, a resolution action must be necessary in the public interest. When the first two conditions are met, and regardless of the whether the third condition is fulfilled, the resolution authority must proceed to write down the capital instruments. If the third condition is also met, the resolution authority must apply one of the resolution instruments, namely sale of the business, creation of a bridge institution, asset separation or bail-in. Finally, the Directive establishes a mechanism for financing resolution measures via the creation of a scheme financed in advance by the sector. This financing mechanism remains national in the Directive, although the intention is that all the funds of countries participating in the SSM are to be pooled in a single resolution fund under the single resolution mechanism [2].

The new banking law will already transpose parts of the Directive. As well as designating the NBB as the resolution authority, that law will introduce an obligation to draw up recovery and resolution plans for credit institutions under

(1) See chapter A, section 3, of the part on "Prudential regulation and supervision" of the Report.
(2) See chapter A, section 3, of the part on "Prudential regulation and supervision".

Belgian law. In accordance with the Directive, the resolution authority will be responsible for assessing the resolvability of each institution and reducing or removing any obstacles to resolution. The new banking law will define the conditions for initiating resolution and will introduce the resolution instruments specified by the Directive. However, although the bail-in principle is enshrined in the law, such an instrument can only be used subject to a Royal Decree debated by the Council of Ministers and adopted on the recommendation of the resolution authority. That Decree will have to be ratified by law within twelve months following its publication in the *Moniteur belge/Belgisch Staatsblad*.

The new banking law will also introduce the instrument for the write-down or conversion of capital instruments, conferring on the resolution authority the power to write them down or convert them into shares if an institution is no longer viable. That is also in line with the approach recommended by the European Commission in its communication on the banking sector dated 10 July 2013 [1]. In connection with the assessment of State aid, the Commission specifies that in accordance with the principle of a fair sharing of the burden, the losses must first be absorbed by the equity, hybrid securities and subordinated debt instruments. Conversely, the Commission does not yet require senior debt holders to contribute to the burden-sharing as they would in the case of a bail-in.

The obligation introduced by the new banking law to draw up a recovery plan for credit institutions formalises the approach already adopted by the Bank. Following the implementation and assessment of two pilot projects conducted and partially completed in 2012, the Bank extended this approach to all D-SIBs in 2013. In addition, the Bank set up a pilot project with an insurance company to provide it with a recovery plan [2]. These various projects also conform to the IMF's recommendation, in the context of the FSAP, on drawing up recovery and resolution plans for all systemically important financial institutions. CRD IV also makes provision for those plans.

In order to facilitate the preparation of recovery plans for the various institutions subject to that obligation, the Bank has developed guidelines detailing the type of information that the recovery plan must comprise. These guidelines are based directly on international experience in this sphere, particularly the instructions which the Bank of England issued to its own institutions, and the EBA's recommendations.

The recovery plan is to consist of various modules dealing with specific questions. The first section describes the governance of the plan and identifies the people within the institution who are responsible for developing it. This module ensures that the management and decision-making bodies of the institution are sufficiently involved in devising the plan. To that end, the institution is asked to confirm that the plan was approved by the institution's board of directors. The second module presents a two-part strategic analysis. The first part gives a full description of the institution's activities and their systemic importance. In particular, the analysis must permit identification of the legal entities that perform functions which the institution deemed critical. The second part of this second module forms the core of the recovery plan, since it identifies the institution's vulnerabilities, draws up crisis scenarios specific to each vulnerability, lists the recovery options that could be implemented and assesses their relevance in each of the stated scenarios. The third module deals with the activation of the plan. It aims to ensure that the recovery plan is integrated into the governance of the business and will be launched sufficiently early for the recovery options to be implemented if necessary. Finally, the last module lists the measures that the institution intends to take so that its plan can be implemented or updated.

2.5 Remuneration policy

There is a broad national and international consensus on the role that financial sector remuneration policies played in the eruption of the 2008-2009 financial crisis. It is clear from all the national and international reports published in the aftermath of the financial crisis that remuneration policy has to form a key element of risk management by financial institutions and prudential supervision of that risk management.

In the transposition of CRD IV, the remuneration policy requirements which, at this stage, appear mainly in the Regulation of 8 February 2011 [3], are all enshrined in the new banking law. That law also contains the limits set by CRD IV in respect of remuneration in institutions receiving exceptional financial support from the government.

The Regulation, which faithfully transposed into Belgian law the requirements of CRD III [4] on an appropriate remuneration policy and came into force on 1 January 2011, is

(1) Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (2013/C 216/01).

(2) On this subject, it should be noted that in October 2012 the European Commission launched a consultation on the recovery and resolution framework for financial institutions other than banks, which deals in particular with the preparation of recovery plans by insurance companies. Following that consultation, the European Commission announced that it would initiate legislation on the recovery and resolution framework of financial institutions other than banks.

(3) Regulation of 8 February 2011 approved by the Royal Decree of 22 February 2011. Mention should also be made of the circular dated 14 February 2011 on the establishment of a good remuneration policy, which refers to the "Guidelines on Remuneration Policies and Practices" of the Committee of European Banking Supervisors, which form an integral part of the Belgian prudential framework on remuneration policy.

(4) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.

based on several pillars. First, it determines the categories of staff to be subject to the remuneration policy (the Identified Staff). Next, it lays down a number of governance principles relating to remuneration policy (notably the responsibilities of the statutory board of directors and the formation of a remuneration committee within it). It also sets out some principles to be respected regarding the link between risks and remuneration. Finally, it lists the elements of the remuneration policy which must be made public.

From the start, the Bank paid great attention to implementing these requirements concerning remuneration policy, notably by arranging horizontal analyses of remuneration practices in the sector. In 2012, on the basis of that experience, the Bank adopted a guideline that introduced a more specific, quantitative interpretation of two constant points for attention in regard to remuneration policy, namely the number of Identified Staff and the appropriate ratio between fixed and variable remuneration [1].

In principle, it was not the intention that CRD IV should rework the provisions on remuneration introduced by CRD III. The main innovation of CRD IV consists in the introduction of a maximum ratio of 1 to 1 between variable and fixed remuneration, with the option for the general meeting to grant a derogation permitting a ratio of 2 to 1. That obligation will take effect from the 2014 performance year and should create a more level playing field. In that respect, the new banking law is expected to impose stricter rules. Another point which should be mentioned is the EBA's mandate to develop regulatory technical standards, particularly on the criteria for selecting the Identified Staff and the conditions under which supplementary Tier 1 and Tier 2 capital and other instruments can be used for remuneration purposes. In regard to the criteria for selecting the Identified Staff, the regulatory technical standards aim at greater harmonisation of the selection processes, in line with the NBB's policy, and should help institutions to start listing their Identified Staff, an exercise that in fact still constitutes a risk analysis. The Bank's guidelines, whereby the Identified Staff must include at least 1 % of the total number of staff, should be viewed as a minimum to be respected after this risk analysis.

In 2013, the NBB embarked on another extensive horizontal analysis of compliance with the rules on remuneration policy by large institutions. By always using the same method to make comparisons between institutions, the Bank aims to encourage a level playing field in the Belgian financial sector. This time, six large institutions were included in the analysis, which looked at performance during 2012 for which variable remuneration was paid at the beginning of 2013. This third horizontal analysis revealed that progress has generally been made on the two points covered by the policy that the Bank adopted in the previous year, namely the number of Identified Staff and the proportion between fixed and variable remuneration.

However, the NBB notes that further progress is needed in the use of mechanisms to facilitate a link between remuneration policy and the risk management of the institutions. There are two aspects to the question of the link between risks and remuneration : an *ex-ante* aspect and an *ex-post* aspect. In the first instance, risks must be taken into account in the performance assessment phase when variable remuneration is decided (*ex-ante*). Since it is impossible to determine all the risks in advance, it may be necessary to make adjustments later ; that is the stage covered by the requirements on the actual payment of the variable remuneration (*ex post*). Thus, part of the variable remuneration can only be paid after some time has elapsed (40 % to 60 % of variable remuneration over a period of at least 3 to 5 years) and at least half of it must consist of financial instruments. This takes effective account of the institution's performance over the longer term.

Finally, on 15 July 2013 and 29 November 2013 respectively, the EBA published reports containing quantitative data on high earners (staff earning over € 1 million per annum). The first report related to performance in 2010 and 2011, and the second to performance in 2012. These reports were based on remuneration data gathered by the national supervisory authorities, including the Bank. For each Member State, the EBA listed the number of high earners in each sphere of activity and the main elements of their remuneration.

(1) For more details on this subject, see the NBB Report 2012, p 210-212.

3. Insurance undertakings

3.1 International environment

The Solvency II Directive[1] aims at radical modernisation of the European legislative framework for prudential supervision of insurance and reinsurance undertakings. The basic goals of this Directive are to ensure that the assets and liabilities of the supervised firms are valued at market prices, and to focus closer attention on the risks to which the firms are exposed and the way in which those risks are managed[2].

The original plan was that the Directive should enter into force on 1 November 2012. However, it emerged that the proposed methods for valuation at market prices could lead to great volatility in the valuations of the firms' capital; that was incompatible with the medium- to long-term horizon of most of their liabilities. It was therefore decided to examine alternative methods aimed at reducing this excessive volatility in the capital, to attenuate the impact of low interest rates on the discounting of the long-term guarantees given by the firms, and to conduct an impact study on these new methods (Long-Term Guarantees Assessment)[3]. At the same time, the entry into force of the Directive was first postponed to 1 January 2014 by the Quick Fix I Directive[4]. The impact study which began on 28 January 2013 combines various scenarios for assessing the effects of the proposed measures on the financial situation of firms (assets, liabilities, capital, minimum capital requirements and solvency ratio), on consumer protection, on the implementation costs and effectiveness of the Solvency II Directive, and on the financial stability and the risk management of firms.

The data on the eight Belgian companies taking part in this study were analysed and validated by the national authorities and by EIOPA. In a report subsequently made public, EIOPA recommended a number of methods to be taken into account for the Long-Term Guarantees Assessment, and proposed that firms should publish the impact of these measures on their financial situation. Under the Omnibus II Directive[5], amending the Solvency II Directive, the presidency of the European Union formulated a proposal for adjustment based largely on the EIOPA report. The preparation of that proposal made it necessary to postpone once again the transposition and entry into force of the Solvency II Directive, to 31 March 2015 and 1 January 2016 respectively. That postponement was incorporated in the proposal for the Quick Fix II Directive[6].

As a result of the delayed entry into force of the Solvency II Directive, EIOPA published an opinion on its website concerning the provisional implementation of that Directive[7]. The Bank notified that opinion to the sector in order to make it aware of the issue and to encourage unremitting efforts in preparation for the implementation of the Solvency II Directive.

On 31 October 2013, following the adoption of that opinion, EIOPA published guidelines for the national authorities on how to proceed during the transitional phase in the run-up to Solvency II. Those guidelines concern four key topics: governance, forward-looking assessment of own risks (based on the principles of Own Risk and Solvency Assessment or ORSA), pre-application for the use of internal models and the periodic submission of information.

(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.
(2) For more details, see the Report 2011, "Financial stability and prudential supervision", p. 55 to 58.
(3) See Report 2012, p. 206.
(4) Directive 2012/23/EU of the European Parliament and of the Council of 12 September 2012 amending Directive 2009/138/EC (Solvency II) as regards the date for its transposition and the date of its application, and the date of repeal of certain Directives (Quick Fix I).
(5) These proposals were to be incorporated in the proposal for a Directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (Omnibus II).
(6) Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) as regards the date for its transposition and the date of its application, and the date of repeal of certain Directives (Quick Fix II).
(7) Opinion on Interim Implementation of Solvency II.

The national authorities are not required to conform to these guidelines, but if they decide not to, they must inform EIOPA and explain their reasons. EIOPA will then publish a notice stating that the competent authority does not comply with the guidelines or does not intend to do so.

With the support of the national authorities, EIOPA has also established a question-and-answer procedure concerning the preparatory guidelines in order to clarify their scope and interpretation, notably in specific cases. The responses will be published on the EIOPA website. They will not be binding, so that the national authorities retain some latitude in the application of the guidelines, e.g. to take account of specific local circumstances.

Finally, the Solvency II Directive will have to be supplemented by implementing measures at various levels, some being binding and directly applicable in the Member States by way of EU Regulations (delegated acts and implementing technical standards), others being simply guidelines for which the Bank will either have to state whether it conforms or intends to conform, or must explain the reasons why it does not wish to do so.

3.2 National legislation

Transposition of the Solvency II Directive and preparatory measures

Work on the transposition of the Solvency II Directive continued during 2013. In view of the uncertainty relating in particular to the treatment of long-term guarantees (see section 3.1), it was not possible to finalise a pre-draft law during the year under review.

In order to prepare firms as far as possible for the new supervision rules, EIOPA published guidelines which aim to anticipate the implementation of certain parts of the new supervision regime. In this respect, the Bank decided on a proactive approach, not only conforming to the EIOPA guidelines but also supplementing them in two respects. First, the obligation to submit information is extended to insurance companies below the minimum thresholds specified in the guidelines, in order to prepare all market players for the future Solvency II rules. However, the Bank intends to ask these firms for less extensive information. Second, firms and groups undergoing the process of pre-application for the use of internal risk management models will have to use the same forms for the information relating to the solvency requirements as those for the submission of information by firms adopting the standard approach. In fact, it is not at all certain that firms or groups submitting an application will actually be granted approval for the use of an internal model immediately on entry into force of the Solvency II Directive.

Circulars have been prepared to implement the content of these guidelines.

The provision for interest rate risk, known as the flashing-light provision

Life insurers and undertakings covering accidents at work still have contracts in their portfolio offering guaranteed yields well in excess of the yields currently obtainable on the financial markets. Insurance companies in such a position have to form a "supplementary" technical reserve. Income from the assets corresponding to that provision is added to that generated by the covering assets representing the life insurance provision so as to guarantee the interest rate level promised in the contract.

The principle and the detailed provisions on the formation of the supplementary reserve are set out in Article 31, § 3, of the life insurance Decree[1]. However, a circular exempts insurance companies from forming that reserve if they can show that the financial flows generated by their covering assets will cover the commitments given in their insurance contracts[2].

Nevertheless, in line with an International Monetary Fund recommendation[3], the NBB suspended the application of that circular during the year under review for two important reasons. The first concerns the current economic situation, which implies that the low level of interest rates will persist for a long time both on the Belgian capital market and on the euro-swap market. The second reason is the need to establish a mechanism tailored more closely to the principles of the future supervision regime to be introduced on transposition of the Solvency II Directive. The Bank is planning to implement a new exemption system to take account of the second reason for the suspension and to ensure that the technical provisions are sufficient at all times in accordance with the current prudential standards.

Acceptance of loans guaranteed by a public authority as covering assets

During the year under review, a pre-draft Royal Decree was prepared with a view to amending Article 10, § 4

(1) Royal Decree of 14 November 2003 on life insurance business.
(2) Circular CPA-2006-2-CPA. See Annual Report 2012, p. 227.
(3) "We recommend that the NBB strengthen its Flashing Light approach and put in place a sound market-consistent valuation standard for total provisions, either as a Pillar 1 or as a Pillar 2 requirement for all insurers".

of the Royal Decree of 22 February 1991, hereinafter referred to as the general regulation [1].

The proposed change relates to the treatment of loans guaranteed by States, regional and local authorities or international organisations, as covering assets, and more particularly the maximum percentage that such loans may represent in the technical provisions. Those loans are generally used to finance long-term public investment projects (infrastructure, telecommunications, hospitals, social housing, schools, prisons, etc.) which correspond fairly well to the maturity of the insurance companies' liabilities.

Since these loans are not accompanied by one of the guarantees expressly listed in the general regulation (mortgage, other real surety, a guarantee by a bank or insurance company) they could only be used as assets covering 5 % of the technical provisions for all loans together and 1 % per borrower, greatly reducing the attraction of these investments for insurance companies. That restriction was illogical since – despite the quality of the guarantor – the general regulation rated these loans as inferior to those guaranteed by a credit institution or insurance company. Conversely, there was no limit for loans granted direct to public entities.

The said pre-draft Royal Decree intends to rectify this inconsistency while keeping this type of investment within the limits set by the European Directives. Two essential changes are proposed for that purpose.

The first consists in according to loans guaranteed by a State [2], a regional or local authority, or an international organisation to which an EEA Member State belongs the same treatment as applies to loans granted direct to those same authorities. The second change concerns the individual limits applicable both to loans granted to those counterparties and to other securities (bonds, equities, etc.) that they issue. Loans guaranteed by one of the said authorities or organisations and other securities issued by the same counterparty can be included in the covering assets at 10 % of the technical provisions per counterparty, on the understanding that the total investments (loans and securities) effected with issuers and borrowers with whom the insurance company places over 5 % of its technical provisions must not exceed 40 % of those provisions.

Local insurers

Local insurers are set up in the form of mutual insurance associations or cooperative societies and confine their insurance business to the municipality where their head office is located or to neighbouring municipalities. They only insure against the risk of fire or related and ancillary risks (theft, water damage, owner's and tenant's liability, assistance in the event of a fire, etc.). The insurance covers simple risks, namely private housing (up to € 1.4 million) and some other real estate (up to € 45.4 million).

Originally, these businesses only fell within the scope of the law on the supervision of insurance companies if that was explicitly specified by a Royal Decree, which was never the case. The new Article 2, § 1 *quater* of the supervision law in force since 1 January 2010 stipulates that these businesses are now subject to all the provisions of the law unless a Royal Decree grants them total or partial exemption. In the absence of such a decree, local insurers are now therefore subject to all the provisions of the law on the supervision of insurance companies.

However, this situation does not tally with the intention of the legislature, which recognised that "the full application of the supervision legislation to these businesses would be a death sentence for them" [3] and that it was sufficient to subject them to "a 'light' supervision regime involving the imposition of a number of rules concerning good governance and compulsory reinsurance with a small retention" [4].

The Bank therefore prepared a pre-draft Royal Decree that aims to maintain much of the exemption regime which was the rule before the change in the law in 2010. This is a provisional solution enabling local insurers to continue operating perfectly legally pending the establishment of a specific supervision regime when the Solvency II Directive is transposed.

However, the pre-draft Royal Decree does provide for local insurers to be registered with the Bank. That registration, which is a requirement for exemption, is subject to a number of conditions, notably the business must have been operating since 1 January 2010, it must limit its activities in regard to both insured property and risks covered and ancillary transactions, it must be largely reinsured and it must submit documents and information enabling the Bank to monitor the maintenance of the conditions for granting registration.

(1) Royal Decree of 22 February 1991 laying down general regulations on the supervision of insurance companies.
(2) Refers only to countries which are members of the OECD or have concluded certain loan agreements with the International Monetary Fund, i.e. more specifically the countries in Zone A as referred to in Article 2 (1) of Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions.
(3) Parliamentary documents, Chamber 52/2292/1, p.35.
(4) Parliamentary documents, Chamber 52/2292/1, p.35.

4. Financial market infrastructures

The regulations on financial market infrastructures underwent a number of changes during the period under review. At European Union level the implementation of the standards laid down by the EMIR Regulation [1] for central counterparties continued. Further work was also done on the European legislation concerning central securities depositories (CSDs). Consultations were initiated at global and European level with a view to the adoption of rules on the recovery and resolution of financial market infrastructures. Finally, work also continued on the regulations relating to payment services.

4.1 Central counterparties: EMIR Regulation

The EMIR Regulation aims to strengthen the European Union's regulatory framework on transactions in derivatives by improving the stability, transparency and efficiency of derivatives markets. It also aims to reduce the credit risk, liquidity risk and operational risk of the counterparties in the clearing of OTC derivative transactions.

The EMIR Regulation and the Implementing Regulations that came into force on 15 March 2013 govern the mandatory use of central counterparties (CCPs) for standardised OTC derivative transactions and lay down risk management requirements, including the exchange of collateral for non-standardised OTC derivative transactions. The EMIR Regulation also introduces an obligation to report derivative contracts to central registers. These rules provide an overview of the operation of the derivative markets and provide the supervisory authorities with data on the derivative contracts of institutions subject to their supervision. The entry into force of the various obligations is being staggered: the obligation to report derivative contracts takes effect in February 2014, while the clearing obligation is set to apply from mid-2014.

These regulations also govern the operation of the trade repositories, which centralise the data on transactions in derivatives concluded by market players. Finally, the EMIR Regulation also establishes the conditions and procedures for granting licences to CCPs, and governs CCP supervision. CCPs are in fact systemically important market infrastructures with a high risk concentration.

Use of a CCP reduces the systemic risk by optimising the risk management of the counterparty and increasing transparency, at least if the CCP itself ensures robust risk management. The EMIR Regulation therefore stipulates, among other obligations, that margins and haircuts must always be sufficiently conservative and that the CCP must have pre-paid financial resources at its disposal to cope with the simultaneous default of the two main clearing members.

4.2 Securities clearing: proposal for an EU Regulation

Since 2012, the NBB has been involved in the work at European level on the new Regulation concerning CSDs. The main aim of this piece of legislation is to establish a harmonised status and a common supervision framework for CSDs in accordance with the international principles of the Committee on Payments and Settlement Systems – International Organisation of Securities Commissions (CPSS-IOSCO) relating to CSDs.

The grant of European CSD status by the national authorities will enable these institutions to operate freely in the EU, including offering issuance services which were previously organised essentially on a national basis. To ensure the

(1) Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

smooth operation of the financial markets and investor protection, there will need to be cooperation agreements between the competent authorities of the countries for which the services offered by a CSD are of significant importance.

The negotiations on this new Regulation are still in progress, and should be finalised in early 2014. After that, ESMA working closely with the central banks will have to develop the technical standards based on this regulation. The Bank is also involved in the working groups set up for that purpose.

The four Belgian CSDs – Euroclear Bank, CIK, Bank of New York Mellon CSD and NBB-SSS – will need to initiate various measures in the coming months to conform to all the new rules under the CSD Regulation. Its implementation in Belgium will also entail a number of changes to the laws and regulations, which are already being prepared.

4.3 Recovery of financial market infrastructures

As a member of the CPSS, the National Bank took part in the international work on the recovery and resolution of financial market infrastructures. That work is aimed at obliging those infrastructures to devise emergency plans to cope with unexpected losses, so that they can continue their critical activities without government financial intervention. Market infrastructures must arrange for the unexpected losses resulting from counterparty default, higher operating costs or loss of income to be allocated *ex ante* among their shareholders, participants and creditors. Various bodies organised consultations on this subject during the period under review. The European Commission started the ball rolling at the end of 2012 by arranging a consultation for non-bank institutions, and the CPSS and the FSB did likewise in July and August respectively. The Regulation is expected to apply in particular to CCPs and CSDs that grant credit.

4.4 Retail payments and non-bank payment service providers

Payment institutions and certain electronic money institutions provide payment services such as payment account cash deposit and withdrawal, transactions via these payment accounts, card payment issuance and funds transfer. The NBB continued work on the implementation of the European Payment Services Directive[1] and the corresponding Belgian legislation. For instance, the Royal Decree of 19 September 2013[2] ratifies the Bank regulation on the capital of electronic money institutions. During the period under review, the Bank also published guidelines governing the prudential status and periodic reporting of electronic money institutions, and the exemption policy relating to payment and electronic money services. At the same time, negotiations began at European level on Payment Services Directive 2, which will refine and update the regulatory framework for payment institutions.

The Bank takes part in the European Forum on the Security of Retail Payments, which aims at the exchange of expertise on the subject between the participating prudential supervisors and overseers. In January 2013 the Forum published recommendations[3] which providers of payment services and payment systems have to apply from 1 February 2015. The aim is to reduce the relatively high incidence of fraud and to create fair conditions of competition for payment service providers. The Forum also arranged a public consultation on access to payment accounts for non-bank payment service providers. The final report on that consultation is expected early in 2014. Finally, in November 2013, it launched a public consultation on the recommendations concerning the security of mobile payments.

(1) Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.
(2) Royal Decree approving the regulation of the National Bank of Belgium of 18 June 2013 on the capital of institutions for electronic money and the investment of funds received in exchange for the electronic money issued.
(3) Recommendations for the security of internet payments, ECB, January 2013.

5. Cross-sectoral regulations

5.1 Conglomerates

Financial conglomerates are groups which, with due regard for clearly defined significance thresholds set out in the Financial Conglomerates Directive (FICOD) [1], combine the activities of the banking and investment sector with those of the insurance sector. The activities of the companies belonging to such groups are deemed significant in a given financial sector if they exceed either an absolute threshold or a relative threshold (Article 3 of the Financial Conglomerates Directive). These groups are headed either by an unregulated holding company (mixed financial holding company) or a regulated undertaking such as a credit institution or insurance company.

In the new banking law, the supplementary supervision of financial conglomerates forms the subject of two substantive amendments.

First, it was a question of transposing FICOD I [2], which amends both the Financial Conglomerates Directive itself and the sectoral prudential directives for the banking and insurance sectors. FICOD I was designed as a relatively limited technical amendment, intended essentially to introduce top-level supervision.

It was also necessary to implement the Joint Forum Principles on the Supervision of Financial Conglomerates which were published on 24 September 2012, redrafting the principles of the same name dating from 1999. The Joint Forum is an international cross-sectoral consultation body operating under the aegis of three founding committees, namely the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the International Organisation of Securities Commissions.

This resulted in compliance with the recommendations made by the IMF in the FSAP [3].

Apart from these substantive amendments, there was a desire for a single, consistent regulatory text in the form of the new banking law, bringing together all the implementing provisions on group supervision [4] in so far as they apply to credit institutions.

Ultimately, the intention is that the changes to the supervision of credit institutions should be mirrored by similar changes for insurance companies via the implementation of the Solvency II Directive.

At European level, the main aim of FICOD I was to remedy an undesirable effect of the original Directive on financial conglomerates. It had emerged that, as a result of the supplementary supervision of the conglomerate introduced by the original text, consolidated bank supervision of the holding company disappeared or was reduced to a lower-level bank consolidation within the financial conglomerate if the group was organised as a financial holding company. To remedy this undesirable effect, the former CBFA, in common with other European supervisory authorities, had made use of the exemption option in Article 3(3) of the Financial Conglomerates Directive [5]. This article stipulates that financial conglomerates which exceed the absolute size threshold – namely a balance sheet total in excess of € 6 billion for the smallest financial sector in the group – but not the relative size threshold

(1) Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC of the Council, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council.

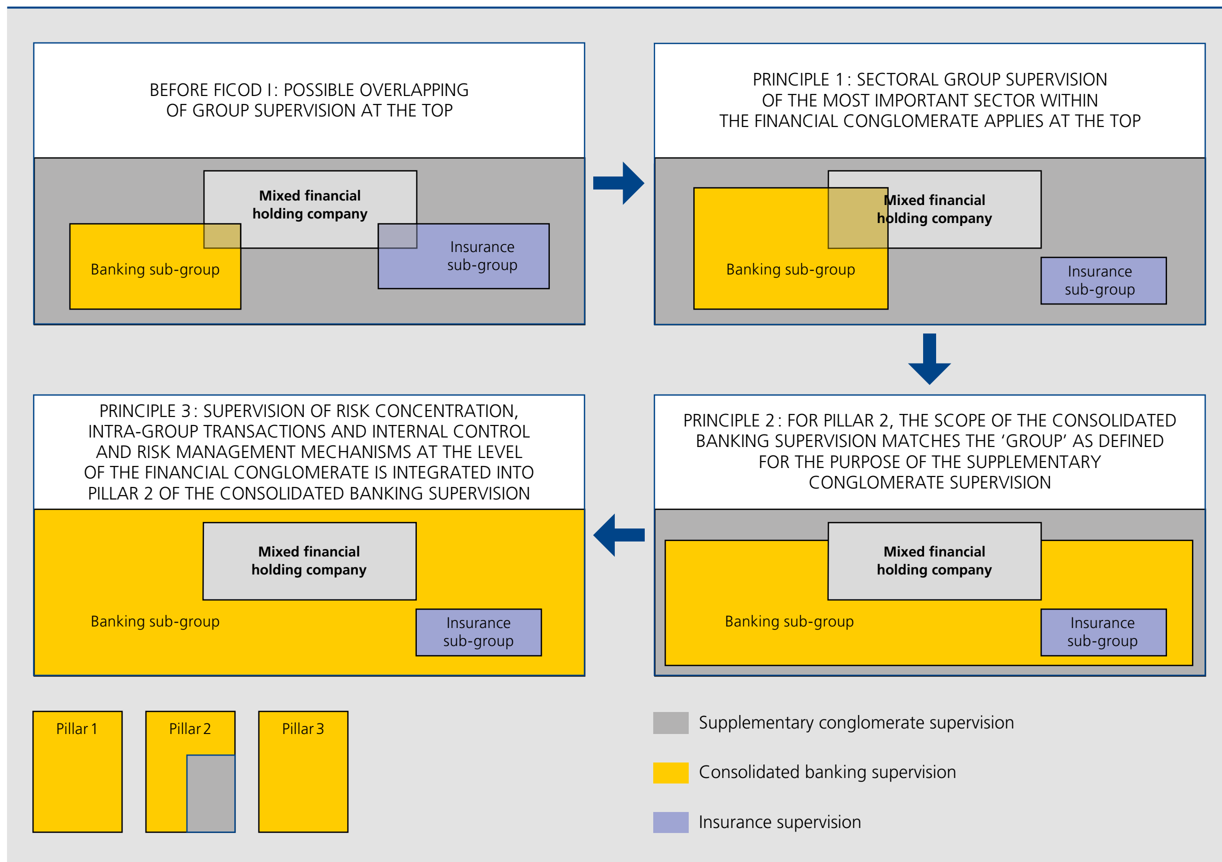
(2) Directive 2011/89/EU of the European Parliament and of the Council of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate.

(3) For more details, see section 1 of chapter C in the part on "Prudential regulation and supervision" of the Report.

(4) This concerns the provisions of the Royal Decree of 12 August 1994 on consolidated supervision and the Royal Decree of 21 November 2005 organising the supplementary supervision of conglomerates.

(5) Transposed at the time by Article 2 § 3, end of the first indent, of the Royal Decree of 21 November 2005.

CHART 7 INTEGRATION OF THE SUPPLEMENTARY CONGLOMERATE SUPERVISION INTO CONSOLIDATED BANKING SUPERVISION



Source: NBB.

can claim exemption from supplementary group supervision. Such exemptions made it possible to maintain consolidated bank supervision at the group's top level. (1)

In order to rectify this undesirable effect, it was decided that FICOD I would introduce a whole set of identical changes in the various sectoral Directives. In CRD III and IV, the term "financial holding company" (i.e. a holding company heading a banking group) was supplemented by the words "or mixed financial holding company") (designating a holding company heading a financial conglomerate). Thus, consolidated banking supervision can also apply at the level of a mixed financial holding company. By this technique, FICOD I reinforces the idea of top-level supervision, so that both consolidated banking supervision and supplementary banking supervision can be applied at the group's top level, regardless of its structure. As a result, group supervision can operate more effectively at the group's central decision-making level, i.e. where most of the strategies will be mapped out for the group as a whole or for the banking sub-group.

When FICOD I was transposed via the new banking law, this additional phrase "or mixed financial holding company" was inserted after "financial holding company".

In addition, the new banking law governs the relationship between consolidated banking supervision and supplementary supervision of conglomerates, an issue which has not so far been clearly resolved in the European texts on the subject. The new banking law applies three principles in order to integrate the supplementary conglomerate supervision into the consolidated banking supervision.

First, to avoid any overlap between insurance group supervision and consolidated banking supervision at the level of a mixed financial holding company, it is stipulated that if the banking sector is the most important sector of the financial conglomerate, it is always solely consolidated banking supervision that will apply at the level of the mixed financial holding company. This does

(1) See the annual report of the CBFA, DC Report 2006, pp. 34 and 35.

not mean that insurance group supervision cannot apply to a lower sub-group of insurance companies within the financial conglomerate.

Next, if a credit institution is part of a financial conglomerate, the obligations and powers relating to risk-based supervision [1] can be determined on the basis of the group as a whole – as defined pursuant to the Financial Conglomerates Directive – as the relevant scope for consolidated banking supervision. This means that the scope of this consolidated supervision – specified in Article 19 of Regulation No. 575/2013 [2] – which is normally confined to subsidiaries of those credit institutions, investment firms and financial institutions, is extended to include all possible subsidiaries and associated companies, and hence also those in the insurance sector.

Finally, in line with the second principle, it is stipulated that the group risks resulting from intra-group transactions and risk concentrations within the financial conglomerate are to be treated separately and appropriately under pillar 2 of the consolidated banking supervision, and that any stress tests at the level of the financial conglomerate [3] can be incorporated in this pillar.

These various principles mean that, for a financial conglomerate in which the banking sector is dominant, the supplementary supervision of the conglomerate can be tailored as far as possible to the consolidated banking supervision so that these groups are subject to only one supervision regime – albeit incorporating additional supervision of the conglomerate – rather than two separate supervision regimes. This also conforms to the IMF recommendations on the supervision of conglomerates in that the baseline supervision which the NBB was to exercise over credit institutions – for both solo and consolidated supervision – is directly extended to financial conglomerates. The baseline supervision of these groups comprises a set of minimum supervisory measures conducted during a specified cycle on the basis of a clear framework enshrined in law, geared specifically to the supervision of the risks inherent in conglomerates (intra-group transactions, risk concentration, complexity, conflicts of interests), and in which financial conglomerates with the same risk profile are subject to the same degree of supervision.

Apart from the capital test for financial conglomerates [4], which aims purely to detect multiple use of the same capital ("double gearing") for the banking sector and investment services and for the insurance sector, it is now also possible, under pillar 2 of the consolidated banking supervision, to make a capital adjustment whereby the risks relating to the conglomerate can be weighed against the benefits of diversification which may result from combining banking and insurance activities.

Although it is ultimately specific to Belgium, this integration between consolidated banking supervision and supplementary conglomerate supervision is supported by various provisions of the Financial Conglomerates Directive. For instance, Article 9 (6) states that the supervisory authorities can align the supplementary supervision of the internal control mechanisms and risk management processes at the level of the financial conglomerate with the sectoral provisions on the Supervisory Review and Evaluation Process (SREP).

The integration is permissible only with the approval of all the competent authorities concerned with the financial conglomerate. That is particularly important for the ECB's power in relation to the supplementary supervision of conglomerates. When this Report went to press, it was still unclear exactly how the ECB intended to implement that. Nonetheless, there are indications that it similarly wishes to conduct the supplementary supervision of conglomerates as part of the consolidated banking supervision.

5.2 Governance

Fit and proper

On 17 June 2013, the NBB published a circular [5] in which it aims to focus special attention on the fit and proper character of the people responsible at the top level of financial institutions.

This new circular, finalised following a public consultation, is addressed to all financial institutions subject to the Bank's supervision. By giving the various types of institution the same guidelines on the assessment of aptitude, the Bank can maintain its consistent treatment of the financial sector. The cross-sectoral fit and proper approach

(1) "Obligations and powers relating to risk-based supervision" (pillar 2 of the prudential supervision) means the obligations concerning the Internal Capital Adequacy Assessment Process (ICAAP), and the rules, processes and mechanisms of credit institutions (governance), and the Supervisory Review and Evaluation Process (SREP) and the associated supervision measures.
(2) Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 July 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.
(3) Transposition of Article 9bis, inserted in the Financial Conglomerates Directive since entry into force of FICOD I.
(4) On the basis of the calculation methods mentioned in Article 6 of the Financial Conglomerates Directive. See also the document entitled "Joint Committee FINAL draft Regulatory Technical Standards on the consistent application of the calculation methods under Article 6(2) of the Financial Conglomerates Directive under Regulation (EU) No. 575/2013 (Capital Requirements Regulation – CRR) and Directive 2013/36/EU", published on 26 July 2013.
(5) The standards of "expertise" and "professional integrity" for members of the management committee, directors, people responsible for independent audit functions, and effective managers of financial institutions (circular NBB _2013_02 of 17 June 2013).

is also connected with the presence of large banking and insurance groups on the Belgian market.

The personnel covered by the circular are those performing or wishing to perform the following functions in a financial institution:
– member of the management committee (whether a director or not);
– director;
– person responsible for an independent audit function;
– effective manager: in institutions with no executive committee or in certain branches.

The circular spells out the responsibilities for assessing aptitude. In that regard, it draws attention to the respective roles of the financial institution, the persons concerned and the supervisory authority. The main principle is that responsibility for selecting and retaining staff with expertise and professional integrity rests with the financial institution itself.

The circular contains detailed guidelines on the assessment of expertise and professional integrity. In that connection, it stresses that fit and proper screening always implies an in-depth assessment process which, on the basis of the various relevant elements, provides the most comprehensive possible picture of a person's aptitude for a particular job. The use of a number of weighting factors, such as the reliability and age of the data, makes it possible to judge the relevance and significance of the available information.

The aspect relating to expertise ("fit") comprises three complementary components: appropriate knowledge and experience, competence, and professional behaviour. The assessment of the first two components takes account of the characteristics of the institution concerned and the (intended) job. In the case of a post within a body comprising more than one person, account must be taken of the composition and functioning of the body as a whole.

The aspect relating to integrity ("proper") extends beyond disqualification, which applies automatically and leaves the NBB no discretion. In fact, the Bank examines the entire history for anything that could affect a person's professional integrity. In some situations, however, the Bank wishes to exercise its discretion very strictly, so that its assessments are then virtually automatic. That applies, for example, if the person was convicted of an offence included in the list of offences leading to disqualification, even if the verdict is still open to appeal.

In principle, aptitude is assessed before the commencement of duties and when duties are changed. However, since the requirements concerning expertise and integrity apply at all times, a new assessment may take place while a person is in post. The circular sets out the practical details of assessments by both the financial institution and the supervisory authority, both before the commencement of duties and during performance of the function.

In regard to the assessments by the Bank, it is stated that the Bank has a wide range of information sources and will make more systematic use of the interview technique for its screenings. Deliberate withholding of information or misinformation will have a negative influence on the assessment and lead to immediate rejection.

The new "fit and proper" policy will be enshrined in law when the CRD IV and Solvency II Directives are transposed into national law.

Within the framework of the SSM, the ECB Governing Council will take the final decision in the event of a negative "fit and proper" assessment for a significant bank. The person concerned will have the opportunity to be heard first.

Obligation to establish a management committee

The ever-increasing complexity of the business of credit institutions and insurance companies, and the requirements resulting from stricter prudential supervision, have long since prompted many firms to optimise their internal organisation by setting up a management committee. The policy of the prudential supervisor on this matter is nothing new and was reflected, for example in a circular concerning good governance[1]. However, in the absence of any legal obligation the approach has so far been confined to recommending the establishment of an management committee.

In the case of credit institutions, the new banking law will make it compulsory to form a management committee, while that obligation will be imposed on insurance companies by the insertion in the current insurance supervision law of a specific provision from the new banking law. That will ensure parallel arrangements for the two categories of financial institution.

The obligation to form a management committee has many advantages from the prudential angle. In contrast to the exercise of effective management, the operation of the management committee is governed by the Company

(1) Circular PPB-2007-6-CPB-CPA.

Code, which guarantees a high level of legal certainty, notably in regard to the collegial aspect of the board, relations between the management committee and the board of directors, separation of the management and supervision functions, and the delegation of powers, common in financial institutions. In addition, the management committee of a financial institution must be composed of directors, which implies equality between its members and identical access to information and mutual control over decision-taking. However, that does not prevent the allocation of separate functions to the various members of the management committee.

The main drawback of this obligation to form a management committee concerns its potential extra cost for small organisations, which sometimes have difficulty in meeting this requirement owing to the shortage of appropriate candidates. If the nature, scale and complexity of the business justify it, the Bank may exempt a credit institution or insurance company from the obligation to form a management committee, or may permit this commitee to include members who are not directors.

5.3 "Citizens' loans"

Credit institutions

The draft law on "thematic citizens' loans" is intended to encourage long-term saving to facilitate lending for the purpose of funding socio-economic or ethical projects. In order to finance such projects, credit institutions will be able to raise funds in the form of savings notes or term deposits, and the income will qualify for tax concessions. These savings notes and term deposits must have a maturity of at least five years. The minimum investment is set at € 200.

Credit institutions can use the funds thus raised solely to provide direct or indirect finance (via interbank loans) for public or private sector projects meeting the conditions laid down by this law and its implementing decrees.

The law stipulates a period of one year for actually allocating the capital raised by these "thematic citizens' loans" to eligible projects. A buffer equivalent to 10 % of the funds raised can also be reserved and invested in secure liquid assets in order to ensure that the credit institution can handle savers' deposits and withdrawals.

The Bank is responsible for monitoring compliance with the rules on the allocation of the funds raised by credit institutions. For that purpose, credit institutions must meet the requirements concerning reporting, the content and frequency of which will be defined by regulation. That reporting supplements the accounting data on the funds raised and the use of the funds which must be recorded under a separate heading pursuant to the draft Royal Decree.

Insurance companies

The scope of the law on "thematic citizens' loans" has been amended to include certain insurance products. The aim is to offer life insurance policies in order to raise capital which can be used to fund socio-economic or ethical projects. The insurance policies in question are single premium class 21 contracts (life insurance with a guaranteed yield), having a minimum term of ten years and offering cover in the event of death which is at least equivalent to the inventory value, so that they are similar to insurance bonds. The right of redemption is limited to 5 % of the theoretical redemption value. In addition, the contracts must qualify for compensation from the Special Protection Fund for deposits, life insurance and capital of approved cooperative societies. The insurance company cannot impose a minimum premium of more than € 200. Finally, the contracts concerned must provide for the formation of a ring-fenced fund as referred to in Article 57 of the Life Insurance Decree.

As in the case of credit institutions, the Bank has to verify whether the allocation of the funds raised by means of these contracts meets the legal requirements.