



# BELGIUM

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### TECHNICAL NOTE ON REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

December 2023

This paper on Belgium was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on November 17, 2023.

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# TECHNICAL NOTE

## REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

Prepared By  
**Monetary and Capital Markets  
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program that visited Belgium during June 7 - 26, 2023. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at

<http://www.imf.org/external/np/fsap/fssa.aspx>

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## Glossary

|             |   |
|-------------|---|
| AML         | Anti-Money Laundering                                   |
| BCBS        | Basel Committee for Banking Supervision                 |
| BCP         | Basel Core Principles                                   |
| CET 1       | Common Equity Tier 1                                    |
| CFT         | Combatting of Financing of Terrorism                    |
| COREP       | Common Reporting (ECB)                                  |
| CRD V       | Capital Requirements Directive V (Directive 2013/36/EU) |
| CRR         | Capital Requirements Regulation (EU)                    |
| CSD         | Central Securities Depository                           |
| EBA         | European Banking Authority                              |
| ECB         | European Central Bank                                   |
| EU          | European Union  |
| FINREP      | Financial Reporting (ECB)                               |
| FMI         | Financial Market Infrastructure                         |
| FPS Economy | Ministry of Economic Affairs                            |
| FSAP        | Financial Sector Assessment Program                     |
| FSMA        | Financial Services and Markets Authority                |
| FT          | Financing of Terrorism                                  |
| GDP         | Gross Domestic Product                                  |
| IFRS        | International Financial Reporting Standards             |
| IT          | Information Technology                                  |
| JST         | Joint Supervisory Team                                  |
| LCR         | Liquidity Coverage Ratio                                |
| LSI         | Less Significant Institution or banking group           |
| ML          | Money Laundering  |
| NBB         | National Bank of Belgium                                |
| NCA         | National Competent Authority                            |
| NPL         | Non-Performing Loan                                     |
| P2G         | Pillar 2 Guidance                                       |
| P2R         | Pillar 2 Requirement                                    |
| QLT         | Quick Look Tool   |
| RCAP        | Regulatory Consistency Assessment Program               |
| SI          | Significant Institution                                 |
| SNCI        | Small and Non-Complex Institutions                      |
| SREP        | Supervisory Review and Evaluation ProcessSingle         |
| SSM         | Supervisory Mechanism                                   |
| TA          | General Supervision                                     |
| TB          | Banking Supervision                                     |
| TCB         | Third Country Branch                                    |
| TN          | Technical Note  |
| TP          | Financial Market Infrastructures and Payments Oversight |

## EXECUTIVE SUMMARY

**The FSAP undertook a targeted review of Belgium’s Less Significant Institutions (LSI) and third-country branches (TCBs) banking regulation and supervision.** In scoping the targeted assessment, the 2018 FSAP recommendations and relevant Euro-Area (EA) regulatory and market developments were taken into account. As a result, the review focused on the supervisory strategy and approach, corporate governance, business model review, credit risk, interest rate risk in the banking book (IRRBB), related party transactions, and authorities’ views regarding the overall EA framework and the transition towards a banking union.

**The Belgium LSI sector and TCBs are relatively small.** While the banking sector accounts for the largest part of the Belgian financial system, only about 10 percent of the banking assets (about 24 percent of GDP) are related to the 16 LSI credit institutions. While there is one material TCB it raises no concerns for retail depositors as it is wholesale funded.

**The National Bank of Belgium (NBB) and Financial Services and Markets Authority (FSMA) have well established processes for prudential, product and conduct supervision of LSIs.** NBB’s framework for bank supervision is well embedded in the Single Supervisory Mechanism (SSM). The NBB has adopted the SSM Supervisory Review and Evaluation Process (SREP) process, imposes Pillar 2 requirements and is in the process of implementing ECB/SSM’s revised Pillar 2 Guidance framework. It has an established process for its off- and onsite supervisory activities that takes into account the risk profile and materiality of the LSIs and third-country branches (TCBs). The FSMA has a well-developed MIFID risk assessment framework and is currently involved in the introduction of a Banking Oath.<sup>1</sup>

**While NBB’s overall supervisory approach is adequate, the regulatory framework for corporate governance could be enhanced.** In particular the supervisory expectations for the supervisory function of non-executive directors should be further clarified and strengthened, including strengthening the role of independent non-executive directors (e.g., as the chair of board committees). In addition, the potential for conflicts of loyalty should be more explicitly considered in the designation of a non-executive as independent. Finally, the ability of control functions to have uncensored independent access to non-executives and board committees could be further clarified. To ensure consistency and quality of financial sector corporate governance frameworks, the NBB should review whether these observations and recommendations are also relevant for other regulated financial sectors.

**NBB has a conservative approach to IRRBB supervision and a good understanding of LSI and TCB business models.** To further enhance its perspective on IRRBB risks, in response to the market turmoil in the first months of 2023, the NBB requested banks to regularly report the potential losses on held-to-maturity securities in case they would need to be sold against market prices. In case of

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<sup>1</sup> The Banking Oath aims to increase the awareness of banks staff on their responsibilities and in the event of breaches they will be subject to disciplinary proceeding before the FSMA.

observed business model weaknesses, the NBB could provide examples of effective early corrective action and intervention.

**Internal decision-making processes and the underpinning of certain decision proposal could in some specific instances be enhanced.** The NBB should ensure that the practices for internal reporting, on onsite inspections and pillar 2 requirements, documenting the evaluation of an institution’s response to onsite examination findings, and the approval of decisions for using remedial actions should be more consistently and explicitly embedded in the formal processes across the relevant departments, whether or not findings are of repeated/continuing nature, and take into account the institutions significance and relevant market information.

**With regard to NBB’s internal supervisory processes some finetuning and continued attention could be useful.** The NBB should continue to ensure adequate staffing for LSI and TCB supervision and continue to carefully consider how to address any supervisory Information Technology (IT) risk concerns. Banks’ internal capital target could usefully be added to the NBB’s internal monitoring. A structured approach for conduct risk and consumer protection information sharing with the FSMA and the Ministry of Economic Affairs should be put in place.

**Table 1. Belgium: Recommendations: Regulation and Supervision of Less Significant Institutions**

| Recommendation   |   | Priority | Timeframe |
|--|---|----------|-----------|
| 1)   | Strengthen and further clarify the supervisory expectations for the supervisory function of non-executive directors and consider strengthening the role of independent non-executive directors (e.g., fulfilling the roles of chair of board committees) (¶41, 43). | H        | NT        |
| 2)   | Consider not to allow independent non-executives to be independent at different levels within a group (e.g., the parent and the subsidiary) (¶45).  | M        | NT        |
| 3)   | Clarify and provide further assurance on the independent reporting of the control functions to the non-executive directors (¶44).   | M        | NT        |
| 4)   | Review whether the corporate governance recommendations are also relevant for other regulated financial institutions (¶48).   | M        | NT        |
| 5)   | Maintain adequate prudential supervisory staffing for LSI supervision to avoid gaps in the supervisory work program (¶55, 63).  | H        | NT        |
| 6)   | Ensure consistent practices across departments for documenting key supervisory decisions related to onsite inspections and their recommendations (¶64).   | H        | I         |
| 7)   | Ensure that all relevant information regarding changes to Pillar 2 Requirements (P2R) and its implications are reflected in the documentation of the internal decision-making process (¶58).  | H        | I         |
| 8)   | Enhance internal NBB reporting by adding banks’ internal capital targets to the ratios monitored (¶54).   | M        | I         |
| 9)   | Collect consumer protection and conduct information in a structured approach to feed into the SREP (¶21).   | M        | NT        |
| Notes:   |   |          |           |
| - All recommendations are addressed to the NBB.  |   |          |           |
| - In terms of priorities, H, M, and L stand for high, medium and low. In terms of time frame, I, NT, and MT stand for immediate (within one year), near-term (within 2–3 years), and medium-term (within 3–5 years). |   |          |           |

## CONTEXT AND SCOPE<sup>2</sup>

**1. Previous FSAPs positively assessed NBB’s regulation and supervision of banks, and the Belgium economy and financial system weathered Covid and recent market turmoil well.** The 2018 FSAP observed that the regulatory framework had been strengthened and that supervision of banks and financial conglomerates had been upgraded markedly. While the Euro-Area and Belgian banks weathered the recent financial market turmoil (e.g., SVB and Credit Suisse) the NBB and FSMA cannot be complacent but should continue investigating lessons learned and adapt the regulatory and supervisory framework where needed.

**2. While there are some areas where the National Competent Authorities can adapt the framework to local circumstances, the wider Euro-Area legislation is now setting the main requirements for banks.** In addition, the Single Supervisory Mechanism (SSM) provides the ECB the responsibility for supervision Significant Institutions (SIs) and oversees the National Competent Authorities (NCAs) in their direct supervision of Less Significant Institutions (LSIs). In view of these arrangements the IMF and ECB/SSM have agreed on principles and practices for the FSAPs of Euro-Area members, and to focus in these FSAPs on LSI regulation and supervision.

**3. The FSAP took note of the most recent Euro-Area Basel Core Principles Assessment and the relevant Euro-Area regulatory developments in this FSAP.**<sup>3</sup> The Basel Regulatory Consistency Assessment Program (RCAP), the 2018 Euro-Area FSAP, and the Euro-Area implementation of Basel III provide relevant context for the FSAP.

**4. In this context, the FSAP undertook a targeted review of Belgium’s LSI and third-country branches (TCBs) banking regulation and supervision.** In scoping the targeted assessment, the assessment focused in particular on the progress made on the 2018 FSAP recommendations and relevant Euro-Area regulatory and market developments. As a result, the review focused on the supervisory strategy and approach, corporate governance, business model review, and particular aspects of credit risk, IRRBB, related party transactions, and authorities’ views regarding the overall EA framework and the transition towards a banking union. As part of the targeted review, the IMF got access to a selection of supervisory files covering the period 2020 – 2022.

**5. The assessor is grateful to the authorities and private sector participants for the excellent cooperation.** The author benefitted greatly from the inputs and views expressed in meetings with the NBB, FSMA, Ministry of Economic Affairs, professional organizations and banks. The team sincerely thanks NBB and FSMA staff for their professionalism, spirit of cooperation, and for making enormous efforts to respond to the meeting and information requests.

<sup>2</sup> This Technical Note was prepared by Dirk Jan Grolleman (IMF).

<sup>3</sup> The first review of Euro-Area bank regulation and supervision was published in June 2018 ([Euro-Area FSAP 2018: Basel Core Principles Assessment](#)).

## MARKET STRUCTURE

**6. The banking sector accounts for the largest part of the Belgian financial system.** At the end of 2022, banks account for 52 percent of financial sector assets at 239 percent of GDP. There are 30 credit institutions, 44 Euro-Area and 5 third-country branches in Belgium. The banking sector is highly concentrated with four banks/banking groups (BNP Paribas Fortis, KBC Bank, Belfius Bank, ING Belgium) dominating the industry with around 73 percent market share by assets. Foreign ownership in the banking industry is 48 percent,<sup>4</sup> one of the highest in the Euro-Area. Two of the top 4 banks are subsidiaries of French and Dutch banks.

**7. Almost 90 percent of the banking sector assets are directly supervised by SSM.** Nine SIs, comprising 14 credit institutions governed by Belgium law, are active in Belgium in 2022. These SIs have a combined market share of about 90 percent and are directly supervised by SSM. The other 16 credit institutions are LSIs and are directly supervised by NBB.<sup>5</sup>

**Table 2. Belgium: Number of Credit Institutions**

| <b>Institutions</b>   | <b>2016</b> | <b>2022</b> |
|---|-------------|-------------|
| <b>Credit Institutions Governed by Belgian Law with Belgium Majority Shareholding</b> | <b>15</b>   | <b>16</b>   |
| <b>Credit Institutions Governed by Belgian Law with Foreign Majority Shareholding</b> | <b>19</b>   | <b>14</b>   |
| EU member states  | 11          | 6           |
| Other States  | 8           | 8           |
| <b>Belgian Branches of Foreign Credit Institutions</b>                                | <b>56</b>   | <b>49</b>   |
| EU member states  | 48          | 44          |
| Other States  | 8           | 5           |
| <b>Total</b>  | <b>90</b>   | <b>79</b>   |

Source: NBB Financial Stability Report 2022.

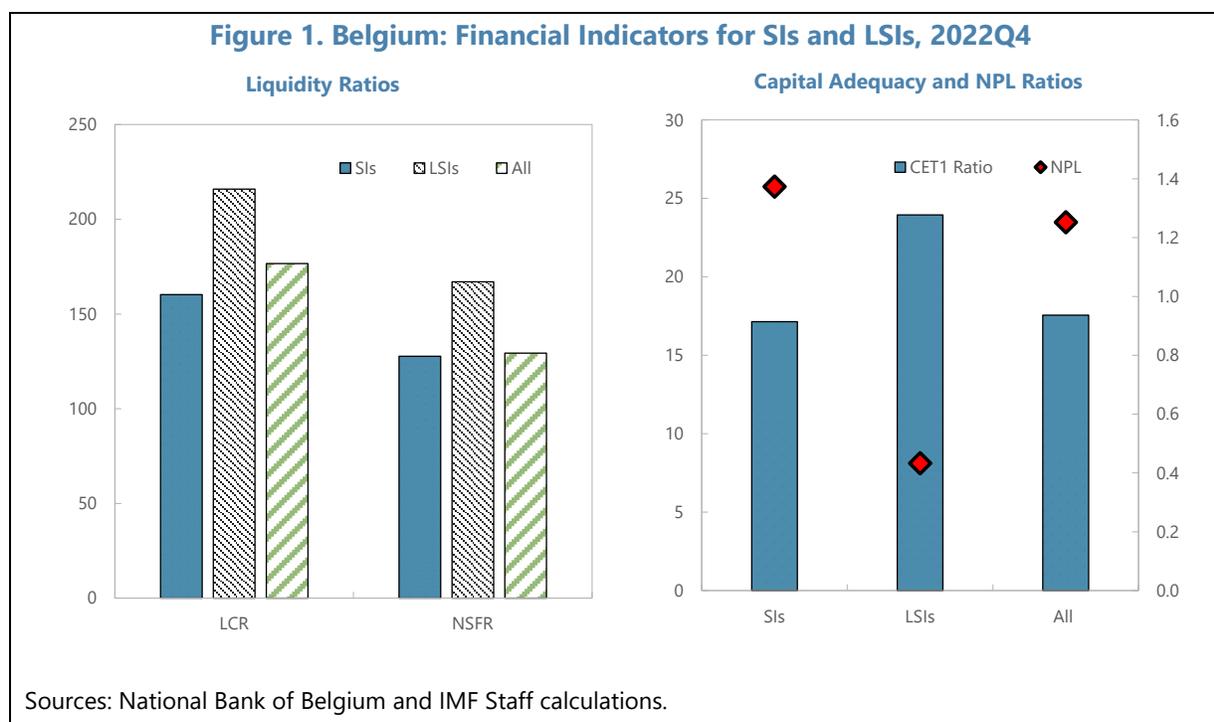
**8. One LSI is related to an international central securities depository (CSD) group and is a systemically relevant institution, while the other LSIs are relatively small.** The balance sheets of the non-systemically relevant LSIs are relatively limited. Two of these LSIs have on a group level consolidated balance sheets of around EUR 10 billion, two others of around EUR 5 billion, and the

<sup>4</sup> Includes foreign branches and subsidiaries.

<sup>5</sup> One LSI wound-down its operations early 2023 in an orderly manner, bringing the number of LSIs to 15.

remaining LSIs have balance sheets well below EUR 5 billion. While their size is limited, a few LSIs offer services in other Euro-Area jurisdictions.

**9. LSI business models are to a large extent focusing on niche markets.** Broadly speaking, nine LSIs are retail or private banks, while others (including the CSD group) are very diverse. One of the LSIs has a digital business model. One of the main challenges for LSIs are the needed IT investments for keeping up with digitalization developments and cyber security. Large incumbents appear better positioned for this given their economies of scale.



**10. The LSI sector weathered the COVID period well and showed on average healthy financial soundness indicators end 2022.** The business model focus on specific niche markets (including retail and private banking) is one of the key factors to the stability of LSI activities and performance. While there is some level of dispersion, LSIs on average had a common Equity Tier 1 of close to 25 percent, Liquidity Coverage Ratio of above 200 percent, and Non-Performing Loans (NPLs) at historically low levels of about 0.4 percent.

**11. TCBs also focus on specific niches and is a relatively small sector.** Apart from one TCB, most have a limited size and are not very active in attracting retail deposits. The largest TCB is fully wholesale funded.

## INSTITUTIONAL SETTING

### A. Supervisory Responsibilities, Objectives, and Powers

**12. SSM is the legislative and institutional framework for the supervision of banks in the EU.**<sup>6</sup> SSM is composed of the European Central Bank (ECB) and the National Competent Authorities (NCAs). The ECB, working closely with the National Competent Authorities (NCAs), is directly responsible for the supervision of SIs and oversees the supervision of LSIs as conducted by the NCAs.<sup>7</sup> In addition to its oversight role for LSI supervision, the ECB has direct responsibility (proposals for approval drafted by the NCA) for licensing, withdrawal of licenses, and qualifying holdings in LSIs. Authorization and supervision of non-European Economic Area bank branches and AML/CFT supervision (for SIs as well as LSIs) is the responsibility of the NCAs.

**13. The NBB is the NCA responsible for prudential supervision of Belgian LSIs and third country branches.** NBB is involved in ECB's SI supervision via their participation in the joint supervisory teams (JSTs). The operational division of responsibilities between NBB and ECB for the supervision of SIs and LSIs is laid down in the SSM Framework. In addition to its role in the SSM framework, the NBB has been attributed the responsibility for the supervision of stock-broking firms, insurance companies, and payment institutions. In addition, the NBB is responsible for the oversight of financial markets infrastructures and payment systems and for macroprudential supervision.

**14. The FSMA is responsible for financial markets and conduct supervision.** The FSMA is mandated for the supervision of management companies Undertakings for Collective Investment in Transferable Securities (UCITS), asset management companies, companies rendering investment advice, supplementary pensions, and for market supervision, including issuance of public financial instruments, and rules of conduct. The scope of conduct supervision also includes bank savings products.

**15. The Federal Administration Ministry of Economic Affairs (hereafter "FPS Economy") is responsible for the conduct supervision of consumer credits and payment services.** FPS Economy supervises the main conduct requirements for consumer loans, credit cards, mortgages and for payment services provided by in Belgium (so covering all licensed banks, Euro-Area branches, third country branches, and the provision of services in Belgium by Euro-Area banks that use the free provision of services across Euro-Area borders).

**16. Within the EU the European Banking Authority (EBA) is tasked with ensuring effective and consistent prudential regulation and supervision across the European banking sector.** EBA

<sup>6</sup> The SSM Regulation and the SSM Framework Regulation set out the fundamental principles governing collaboration within the SSM.

<sup>7</sup> Although the ECB has the authority to take enforcement action and take over the direct supervision of an LSI, in practice so far has relied on the NCAs and only in exceptional circumstances assisted in onsite inspections or taken over supervision of certain institutions at the request of NCAs (e.g., assisting in stressed situations and circumstances in which NCAs were resource constrained).

is an independent EU authority and is governed by a Supervisory Board which is composed of EBA's Chairperson and one representative of the national supervisory authorities of every EU member (in case of Belgium a representative of the NBB). The main task of the EBA is to contribute to the creation of the European Single Rulebook on banking supervision, as well as to coordinate measures to prevent and counter the use of the financial system for the purposes of ML/FT.<sup>8</sup>

**17. The EU Commission can initiate proposals for EU banking regulations, which require the approval of the EU Council and EU parliament.**<sup>9</sup> The Council, comprising a representative of all EU member-countries, and Parliament can review the Commission's proposals and propose amendments.

## B. Cooperation and Information Exchange

**18. The NBB exchanges constructively all the necessary LSI information to the SSM and complies with the required notification requirements.** In addition to the scheduled regular call with the SSM country desk, the NBB provides the SSM amongst other with the LSI Annual Report, including the prioritization and work planning, assessment of significance (of High Impact and High Risk LSIs), and information that allows for the monitoring of LSI risk metrics.

**19. Some forms of collaboration between the NBB and the FSMA in relation with conduct issues are in place, in line with the Belgian regulatory requirements.** The law provides that the NBB shall decide on the application for authorization of a credit institution and for this purpose also obtain advice of the FSMA with regard to the adequacy of the organization of the credit institution, in particular its integrity policy, from the point of view of compliance with the rules of conduct. Similar provisions are provided for by law for stockbroking firms.

**20. In addition, the NBB and FSMA adopted in 2013 a cooperation protocol.** Following these provisions, in the first quarter of the year, the FSMA's Inspection Team has a coordination meeting with the inspection teams of the NBB to discuss the year's planning. The purpose of this meeting is to avoid to the extent possible the simultaneous presence of inspection teams or to coordinate them in case the simultaneous presence of both teams turns out to be necessary. Pursuant to the cooperation protocol, the FSMA systematically sends to the NBB a report of the conduct inspections carried out with entities registered with the NBB. There are also periodic meetings at management level between the NBB and the FSMA. The FSMA has no direct contact with SSM. Where relevant, the FSMA informs the NBB about any findings or concerns it may have with regard to SIs or Euro-Area branches. The NBB passes this information on to the relevant JST.

**21. Information sharing on consumer protection and market conduct could be further improved.** While the FPS Economy and FSMA have information sharing practices, there is no

<sup>8</sup> The EU's European Commission (EC) is readying plans to create a new anti-money laundering agency (AMLA) to oversee AML/CFT efforts across the EU. This agency would replace the current dedicated unit established within EBA and expand the EU's regulatory powers.

<sup>9</sup> For a general overview of the EU's policy setting process see [Legislation \(europa.eu\)](http://legislation.europa.eu).

structured approach between the FPS Economy and the NBB to share information; the NBB does not obtain in a structured manner information about consumer complaints or the risk assessment of the FPS Economy. Despite the active information exchange between the FSMA and the NBB, the NBB has not inquired and received information about FSMA's risk assessment of banks. The information exchange, in particular that could be useful from a risk assessment perspective, could be enhanced and help to better inform the NBB of potential consumer protection and conduct issues and taking these into account in its risk assessment and Supervisory Review and Evaluation Program (SREP).

## C. NBB Internal Structure and Coordination

### Relevant Departments

**22. For supervision the main relevant NBB departments are: General Supervision (TA), Supervision of Banks (TB), and Payments Oversight (TP).** The TA Department (about 56 fte) covers macroprudential supervision, microprudential policy, governance & accounting policy, and off-site AML/CFT supervision. The TB Department (about 124 fte) covers off-site prudential supervision, on-site prudential supervision, and some support functions. Staff of this department also participates in the JSTs; about 60 percent of the resources of the on-site prudential staff are allocated to work on SIs. The TP Department (about 51 fte) focuses on Payment Systems and Financial Market Infrastructures (FMIs) oversight, including that of CSDs. For efficiency reasons the prudential supervision of the LSI that is part of the CSD group is also conducted by the TP Department.

### Internal coordination / decision preparation

**23. In addition to the regular day-to-day interaction between divisions and departments, several committees play a key role in the internal coordination and decision preparation.** The committees do not have a decision-making mandate, but play a role in discussing policy proposals, decision preparation, internal cross-departmental and divisional coordination, and benchmarking.

- **The Risk Committee** regroups all prudential services (heads of department) and the director responsible for microprudential policy (part of TA). The committee discusses regulatory policy proposals (draft circular letters, regulations etc.) and horizontal analyses regarding banks' risks before they are escalated to the NBB Board for decision-making.
- **The SSM Risk Committee** regroups prudential services that deal with bank policy and supervision (TA-TB-TP), the legal and international coordination departments and the director responsible for banking supervision. The committee is used to brief the director before SSM Supervisory Board meetings and to discuss SSM-related topics including strategic decisions taken by Belgian SIs.
- **The Macro-Financial Committee** regroups prudential services (heads of department) with the financial markets, statistics and economic research departments. The committee deals with all

macro-prudential policy analyses and proposals before they are escalated to the NBB Board for decision-making.

- **The Committee of T-services (cTc) and PRIME Committee** regroups prudential services (including the operational departments and divisions, such as IT and data collection) and deals with cross-functionalities between these services for operational aspects (such as the gathering of prudential reporting etc.), insofar as these topics are not covered elsewhere in the context of the NBB's general operation.
- **Climate Change Hub** is a cross departmental information sharing platform. The mission of the climate hub is around information sharing, bringing together expertise and disseminating information. The work of the climate hub also involved the implementation and update of a climate risk dashboard. The work on climate risk has so far mainly focused on creating awareness and gathering data.

**24. The NBB conducts an Annual Risk Review, which is an important input for the planned supervisory and policy priorities across banking, insurance and FMIs.** The risk assessment takes into account the geopolitical situation, the macro-economic and business environment, and ensuing major risk drivers. Per sector the assessment results in work priorities, but also identifies issues relevant across sectors (e.g., related to climate, digitalization, AML/CFT, and macroprudential work). The SSM priorities for addressing vulnerabilities are taken into account in the risk review of the banking sector. The NBB is currently in the process of embedding the Annual Risk Assessment further its global management cycle by connecting it more explicitly to its prudential strategy and budgeting processes.

## LEGAL AND REGULATORY FRAMEWORK

### A. Euro-Area Regulatory Framework

#### Introduction

**25. European Directives, Regulation and Guidelines detail the requirements for Belgian banks.** European Directives need to be transposed in domestic law, while European Regulations have direct applicability in the EU member countries. Belgium transposed Capital Requirements Directive V (CRD V) by making the necessary modification to the Belgian Banking Law, while the Capital Requirements Regulation II (CRR II) is directly applicable.<sup>10</sup> The directive and regulation are the EU tools for the implementation of the Basel capital and liquidity framework. The Euro-Area

<sup>10</sup> CRD V was amended in 2019 – with regards to exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers, and capital conservation measure – and transposed by amending the Belgian Banking Law in 2021. CRR II was issued in 2019, amending the 2013 CRR as regards the leverage ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012.

framework is further complemented by EBA Guidelines which are adopted in Belgium via NBB circulars (and, to the extent needed, through legal amendments).

**26. The 2018 FSAP made recommendations to improve the regulatory and supervisory framework of banks.** With regard to credit risk, the 2018 FSAP recommended the NBB (and SSM) to: i) play a more active role in assessing loan classifications to ensure prudent provisioning practices; ii) to continue enhancing the reliability and consistency of internal models used to calculate regulatory capital; and iii) to strengthen the regulation and monitoring of transactions with related parties. The 2018 FSAP also made recommendations related to off-balance sheet activities and risk of special purpose entities, however, this type of activity is not practiced by LSIs. Finally, the 2018 FSAP recommended to minimize the risk and unintended consequences of the transitioning process towards a banking union. The current FSAP reviewed to what extent these recommendations have been implemented for LSI regulation and supervision in Belgium and took note of the local National Competent Authorities' views on the transitioning process towards a banking union.

### Supervision of Loan Classification and Internal Models

**27. Several measures have been taken to improve loans classification practices.** EBA issued Guidelines on the management of non-performing and forborne exposures (EBA/GL/2018/06) which the NBB adopted in 2019 with a circular. In addition, EBA issued Guidelines (EBA/GL/2016/07) on the application of the definition of default under Article 178 of Regulation (EU) No. 575/2013. The NBB adopted these Guidelines by issuing a circular in 2019. Besides this, the EBA has launched an IFRS 9 benchmarking exercise with the aim of getting a good view at the banks' implementation of IFRS 9. The ultimate goal would be to have a certain harmonization of provisioning practices. The pilot of the exercise ran in 2019 and is now becoming an integral part of an annual benchmarking exercise. The FSAP review of inspection practices indicated that the Belgium authorities undertake corrective action in case LSI banks deviate from appropriate classification practices.

**28. The recommendation on internal models is mostly relevant for the SSM as only 2 Belgium LSIs use internal models.** The NBB actively participated in the SSM's TRIM (Targeted Review of Internal Models) project for Significant Institutions. On-site inspections took place in Belgian banks to conform to the scope and methodology defined for TRIM. The NBB expects the same quality standards in its supervision of the internal models of the two LSIs.

### Related Party Transactions and Intragroup Transactions

**29. The Euro-Area framework for related party transactions improved, but is largely limited to members of the management body.** On a European level, article 88.1 of CRD V, lays down the principle that data on loans to members of the management body (and parties related to

them)<sup>11</sup> should be properly documented and made available to competent authorities upon request. The CRD obligations are also the subject of guidance in the EBA Internal Governance Guidelines, chapters 12.1 and 12.2. In deviation from the Basel Core Principles, loans to shareholders or intra-group exposures and transactions are however not subject Euro-Area's related party framework.<sup>12</sup> However, a broader defined set of related party transactions and exposures (following the IAS 24 definition) are subject to FINREP reporting (schedules F31.01 and F31.02), but on a consolidated basis. In addition, intragroup exposures, on an individual basis, also need to be reported (Schema A and COREP ALMM reporting).

**30. The Belgium related party transaction framework is broader than the definition provided in the CRD and EBA Guidelines.** The Belgium authorities broadened their definition of related party transactions in line with the 2018 FSAP recommendations. The Belgian framework already included transactions with all (executive and non-executive) board members and shareholders (and parties related to them). The authorities modified in 2019 in the Belgium Banking Law the scope of related party transaction to cover all transactions generating risk for the bank including with parent companies, subsidiaries, and sister undertakings. Related party exposures with board members and shareholders (natural as well as legal persons) larger than EUR 500,000 are subject to annual NBB reporting. The framework, like in the EBA Internal Governance Guidelines, is further complemented with conflict of interest guidelines for decision making processes on related party transactions.

**31. Belgium imposes stricter limits than common in the Euro-Area framework on intragroup exposures of Belgian banks to foreign parent companies and subsidiaries.** The ECB has decided to exercise a provision foreseen under Article 400(2)(c) of the CRR, which fully exempts intra-group exposures from the large exposure limits in so far as the relevant undertakings are established in the European Union. However, the NBB applies Article 493(3)(c) of the CRR and imposes stricter limits on intragroup exposures of Belgian banks to foreign parent companies and subsidiaries. Foreign intragroup exposures cannot exceed 25 percent of the limits set out under the CRR and under no circumstances, 100 percent of Tier 1 capital. This article is applicable to all Belgian SIs and LSIs during the transitional period foreseen under the CRR - until 31 December 2028. To further monitor intragroup transactions and have the ability for early (micro- and macro-) prudential intervention, the Belgium Banking Law requires approval of intragroup transactions that have strategic implications (see paragraphs 36 and 37 for more details).

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<sup>11</sup> For the purposes of this Article, the term 'related party' means: (a) a spouse, registered partner in accordance with national law, child or parent of a member of the management body; (b) a commercial entity, in which a member of the management body or his or her close family member as referred to in point (a) has a qualifying holding of 10 percent or more of capital or of voting rights in that entity, or in which those persons can exercise significant influence, or in which those persons hold senior management positions or are members of the management body.

<sup>12</sup> According to the Basel Core Principles for Effective Supervision (2012) related parties include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

## Euro-Area Framework

**32. The Belgian authorities are concerned about the dilution of the Basel III framework in the Euro-Area adoption process.** While the adoption of the Basel III framework provided for a chance to address existing dilutions (e.g., the Danish compromise),<sup>13</sup> the existing implementation proposals go in the opposite direction and propose further dilutions. Concerns in this regard have also been expressed by the ECB and the dilutions could further undermine the Euro-Area's compliance with the Basel capital and liquidity framework.<sup>14</sup> Another challenge for Belgium is the increasing emphasis by the SSM on the group level capital and liquidity requirements, which potentially results in lower capital and liquidity levels at the subsidiary level. While the Belgium authorities are fully supportive of the single market, their continuing emphasis on maintaining sufficient capital and liquidity in cross-border subsidiaries until a common deposit insurance scheme and a common fiscal backstop for systemic events are in place is an understandable approach.

**33. The Belgian authorities are in favor of adopting a Euro-Area harmonized framework for third country branches (TCBs).** In the current Euro-Area framework the NCAs are responsible for the authorization, regulation and supervision of third country branches. Harmonizing and establishing a Euro-Area framework could be useful to avoid undue risks and competition for TCBs between SSM member jurisdictions. Depending on whether the framework for TCBs will be adequately covered in the ongoing CRD review, the Belgium authorities will consider whether the existing Belgian asset coverage requirement of TCB retail deposit funding will need to be reviewed.<sup>15</sup>

**34. While Euro-Area branches are not subject to NBB's prudential supervision, they need NBB approval to start operations in Belgium.** While branches from Euro-Area banks are in the SSM framework subject to a notification procedure, Belgium's legal framework requires that they also obtain NBB approval. In case of concerns (e.g., with regard to AML/CFT or other regulatory concerns) the NBB can withhold the approval and has done so on occasion.

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<sup>13</sup> The "Danish compromise" method allows, if certain conditions are met, that certain investments/holdings in insurance subsidiaries of banks (a structure that exists in some Belgium financial conglomerates) are risk-weighted at 370 percent (as all banks concerned use internal ratings-based approaches to calculate exposure to credit risk) instead of being deducted from capital.

<sup>14</sup> See for example <https://www.ecb.europa.eu/press/blog/date/2022/html/ecb.blog221104~34240c3770.en.html>.

<sup>15</sup> In Belgium, third country bank branches are required to hold a minimum amount of "in Belgium seizable assets" equal to the amount of Deposit Guarantee Scheme (DGS) eligible deposits, unless insolvency laws of the third country ensure equivalent treatment to the branch depositors to that of creditors depositors of the third country institution.

## B. Belgian Macroprudential Powers<sup>16</sup>

### Introduction

**35. This section gives an overview of the macroprudential powers and frameworks that provide an important context to the microprudential framework.** Some of these powers, like those on strategic decisions and intragroup transactions, also indirectly allow the authorities to better monitor SIs and to some extent influence prudential decisions that under the direct supervisory responsibilities of the ECB/SSM.

**36. The Belgian authorities are responsible for macroprudential supervision and measures for all banks (LSIs as well as SIs).** While the microprudential framework is determined on a Euro-Area level, the NBB is responsible for macroprudential supervision and measures, like the countercyclical capital buffer (CCyB), (sectoral) systemic risk buffers, and buffers for systemically relevant banks and other systemically important institutions.<sup>17</sup> At the time of the FSAP mission, imposed measures included a sectoral systemic risk buffer on retail residential real estate exposures for banks using internal rating based (IRB) models. This buffer increases the computed risk-weighted assets (RWAs) by 9 percent. In addition, while the NBB has no explicit powers to set borrower-based measures, it has issued supervisory expectations on a range of indicators which serve a benchmarks for mortgage loans issuance, applying to banks as well as insurance companies. The indicators covered comprise the loan-to-value (LTV), debt-to-income (DTI) and debt-service-to-income (DSTI) ratios. At the time of the FSAP mission the CCyB was not activated but shortly after the targeted review the NBB announced its reactivation.

### Strategic Decisions and Intragroup Transactions

**37. The Banking Law (article 77) requires prior authorization of strategic bank decisions, and the authorization process can also take into account macroprudential considerations.**<sup>18</sup> The requirement is applicable to all banks; SIs as well as LSIs. From a microprudential perspective the ECB is responsible for the authorization process of SIs. The NBB may also use this power from a macroprudential perspective for SIs and advise the SSM on the approval request. SIs therefore have

<sup>16</sup> For more details on the macroprudential framework and policies please refer to the TN on the Macroprudential Policy Framework.

<sup>17</sup> It should be noted however that macroprudential measures listed in EU legislation (CRR and CRD) are also subject to top up powers of the ECB.

<sup>18</sup> This is a Belgium specific power. "Strategic decisions" are all decisions of a certain importance, taken by a credit institution or an entity under its control, that can therefore have a more global impact on the credit institution, insofar as various functions of the institution would be involved or affected by such a decision, relating notably to acquisition or establishment of institutions, the setup of or participation in a joint venture, the establishment in another country, new cooperation agreements with other institutions, the contribution or acquisition of portfolios or activities, or mergers or demergers. It also covers decisions to acquire shares in a non-financial institution for an amount above EUR 250 million or for an amount exceeding 5 percent of the capital of the credit institution. Art. 3, 63 of the Banking Law further provides that 'the competent authority' can specify, via an "Article 12bis of the Organic Law" NBB regulation, which decisions should be considered as 'strategic' (and which therefore require the prior authorization of the supervisor), taking into account the risk profile and the nature of the activities of the supervised entity.

to submit a copy of their pre-approval file to the NBB as well. While taking into account NBB's macroprudential perspective, ultimately the decision-making power for SIs is with the SSM/ECB.

**38. In addition, the NBB put in place a mechanism that requires banks (including SIs) to have independent non-executive board members to evaluate intragroup transactions.** This mechanism was put in place as certain decisions or practices at group level potentially could give rise to an intragroup conflict of interest which should be identified and brought to the attention of the governing bodies of the subsidiary and parent institution responsible for the group. In the case of intra-group operations or transactions (including dividend distributions) that are potentially material to the subsidiary, the NBB Governance Manual requires banks to put in place the necessary safeguard mechanisms and set up an ad hoc committee of independent non-executive directors to issue an opinion to the board on the transaction.

## C. Belgian Microprudential Specificities

### Introduction

**39. Belgium is complying in its regulatory framework with all but (certain parts of) a few EBA Guidelines.** Due to country specific legislation as well as prudent practices, Belgium declared that it will not comply with the EBA Guidelines on: i) internal governance; ii) the assessment of the suitability of members of the management body, and; iii) technical aspects of the management of IRRBB under the supervisory review process.<sup>19</sup> The details will be discussed in the following paragraphs.

**40. Belgium also has some other country specificities, which are usefully all covered in a manual.** This Manual has been prepared in order to keep all NBB and ECB/SSM supervisors abreast of the specifics of Belgian banking regulation and is accessible for JST collaborators.

### Governance and Fit & Proper Requirements

**41. For NBB regulated financial institutions Belgium has a one-tier Board system of which the majority should be non-executives.**<sup>20</sup> The one-tier model has some Belgian specificities, like the requirement that all members of the management committee are a member of the Board. The Banking Law requires that the chair of the Board is a non-executive director, but not necessarily an independent non-executive director. However, a combination of chairmen of the board of directors and chairman of the management committee could be allowed if approved by the NBB (i.e., the institution can request the NBB to waive this requirement). This combination of functions is however not advocated by the NBB, and no such waivers have been granted.

<sup>19</sup> <https://www.eba.europa.eu/about-us/legal-framework/compliance-with-eba-regulatory-products>.

<sup>20</sup> The general corporate governance framework in Belgium was revised in 2019 and allows in addition to a one-tier also for a two-tier board system.

**42. The relevance and role of independent non-executive board members in the governance framework for banks could be enhanced.** The framework does not comply with two specific points of the EBA Internal Governance Guidelines relating to global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs), and also deviates on these points from the Basel Corporate Governance Principles. The first point of non-compliance relates to the composition of the specialized committees of board. The Belgian Banking Law and the Governance Manual require the members of those committees to be non-executive board members, but, except for the audit committee, only require one independent non-executive board member. In addition, one non-executive board member may not sit in more than three of the aforementioned committees. In particular, the provisions for governance do not require the chairs of the committees to be independent non-executives. The second point of non-compliance relates to the number of specialized committees a non-executive director can chair. The Belgian Banking Law does not prohibit the chair of the risk committee and the audit committee to chair the board or any other committee, contrary to the EBA Guidelines. Instead of a requirement, the NBB has formulated it as a best practice for all credit institutions (significant and less significant) in the NBB Governance Manual.

**43. The non-compliance with the EBA Assessment of the Suitability of Members of the Management Body Guidelines relates to two points, but could be interpreted as defensible in the context of proportionality.** The first point of non-compliance relates to the calculation of the number of directorships for the assessment of the time commitment. According to Belgian Banking Law, the exercise of several directorships in undertakings in which other entities of the banking group have a qualifying holding, shall unlike the EBA Guidelines be counted as one single mandate and not as separate mandates. EBA only allows to count all directorships in entities in which the bank itself has a qualifying holding as a single mandate. For all other aspects of the combination of directorships, Belgian Banking Law is compliant with the EBA Guidelines. The second point of non-compliance relates to the assessment by the competent authority of the suitability of the Chief Financial Officer (CFO) in the case where he/she is not part of the Board/Executive Committee of a significant CRD-institution. Unlike in the EBA Guidelines, in such a case there is no requirement for a supervisory suitability assessment of the CFO. These specific non-compliance issues could to some extent be defended for small LSIs in the context of proportionality.

**44. The supervisory guidance on the expectations of the supervisory function of the non-executive board members could be strengthened.** As incorporated in the EBA Guidelines, the Basel Principles for Corporate Governance highlight that the chair of specialized board committees should be an independent non-executive board member. The Basel Core Principles for Effective Banking Supervision indicate that the board, has a role in approving and overseeing the implementation of the bank's strategic direction, risk appetite and strategy, and related policies, establish and communicate corporate culture and values (e.g., through a code of conduct), and establish conflicts of interest policies and a strong control environment. In Belgium this is a responsibility of one-tier board as a whole. While the NBB Governance Manual points to the role the board committees have in the supervisory function, it does not really specify or explain how the non-executives are expected to conduct their supervisory function in the board. Also, when it comes

to collective suitability, the NBB Governance Manual does not specifically mention collective suitability requirements for the non-executive board member in their supervisory function, but rather points to the collective suitability of the board in its entirety. Usefully the Governance Manual could provide more guidance on the expectations of the supervisory function of the non-executive board members, including on the review of the functioning and performance of the executives and Executive Committee.

**45. The NBB should consider slight rewording the Governance Manual to allow for more discretion in the board reporting of control functions in case of specific concerns that may be perceived as sensitive by the Executive Board.** The current wording of the NBB Governance Manual might inhibit the control functions in communicating any concerns they have with the relevant board committee. While the head of risk management, compliance and audit have direct access to the board, it should be noted that the board also comprises executives. While the board committees are comprised of non-executives, also their report goes to the entire Board. This might restrain these officers in providing direct inputs to the supervisory board members on specific concerns they have.

**46. Finally, the framework could take a more pronounced approach to potential conflicts of loyalty and the impact this may have on the independence of non-executive directors.** In the current framework an independent non-executive director at a parent company, could also qualify as an independent non-executive director of the subsidiary. While the Governance Manual discusses measures to address conflicts of interest, it could take more explicitly into account also the issue of conflict of loyalty and not allow non-executive board members to be also considered independent at subordinate entities within the group.<sup>21</sup>

**47. It should also be noted that in certain aspects the Belgian governance and fit & proper requirements are stricter than the EBA Guidelines.** Instead of ex-post, new members of the board receive a fit and proper (FAP) review by the NBB before their appointment. In addition, Belgium imposes stricter variable remuneration requirements. As far as remuneration is concerned, the variable part is capped at 50 percent of the fixed remuneration. This cap is stricter than the maxima provided in in Article 94.1 (g) of Directive 2013/36/EU (which allows 100 or 200 percent if shareholders approve). Setting a more conservative cap is however allowed by the Directive.

**48. The NBB should review whether the observations and recommendations related to the governance framework for banks are also relevant for other regulated financial institutions.** The FSAP only reviewed the Belgian corporate governance framework for banks. However, some of the observations and recommendations may also be relevant for the governance framework of other regulated financial institutions. The recommended review should ensure consistency, while considering sectoral specificities, and quality of the corporate governance framework across the different financial sectors regulated and supervised by the NBB.

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<sup>21</sup> A conflict of loyalty can arise when a non-executive board member is also loyal to the parent company which could prevent him/her from making a decision only in the best interest of the subsidiary, even though there may not be any personal gain, or gain for persons connected to him.

## Interest Rate Risk in the Banking Book

**49. Belgium is the only EBA member that declared, for sound prudential reasons, non-compliance with the Guidelines on Management of Interest Rate Risk Arising from Non-Trading Book Activities.** While Belgium also entirely complies with the EBA Guidelines on IRRBB (EBA/GL/2018/02), it has adopted a more conservative approach for the supervisory outlier test by imposing more restrictive limits on Non-Maturity Deposits (NMDs). EBA adopted in October 2022 a new regulatory package on IRRBB. Most LSIs are expected to adopt the new standardized approach which sets out standardized assumptions for behavioral modelling of NMDs and the specificities of the supervisory outlier tests are now set out under dedicated Regulatory Technical Standards which are directly applicable to all institutions in the EU. In this sense, NBB will be obliged to revise its circular in 2023, ensuring full alignment with the EBA framework. While the new package might on average for the Euro-Area be stricter than the existing EBA guidelines, it is less strict than the current approach adopted by the NBB.

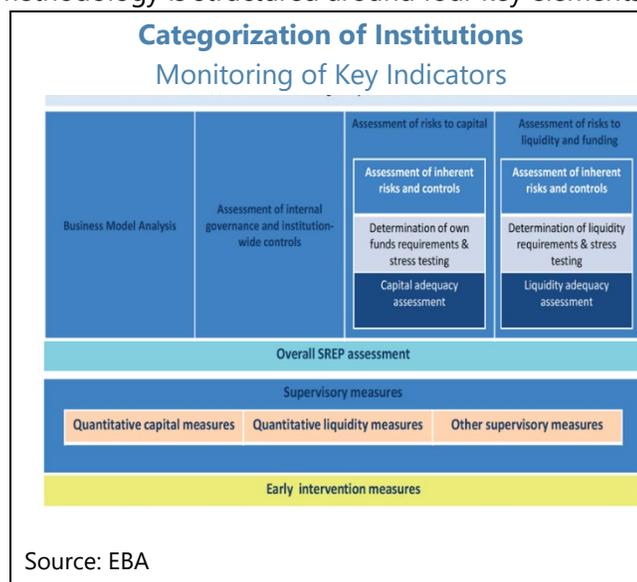
## BANKING SUPERVISION

### A. Supervisory Approach

**50. NCAs have considerable freedom to develop their supervisory approach on the basis of the SSM LSI oversight framework.** While the ECB sets overarching boundaries (e.g., in terms supervisory priorities, SREP methodology, joint supervisory standards, supervisory cycle, while allowing for a proportionate approach), NCAs can develop and tailor within these boundaries their own supervisory framework and approach for LSIs.

**51. A new SSM LSI classification regime entered into force on the 1 January 2022.** The new LSI classification methodology introduces the categories of High-Impact (HI) LSIs and High-Risk (HR) LSIs, which are identified using separate impact and risk criteria. This methodology replaces the LSI High-Priority (HP) concept used before. At least three LSIs per country should be classified as HI to ensure a minimum coverage, while exceptions are possible. An LSI that is considered a small and non-complex institution (SNCI) within the meaning of CRR II cannot be designated as a high-impact LSI unless it is the largest LSI in a jurisdiction where all LSIs are SNCIs. LSIs are classified as HR on the basis of a risk assessment by the NCA and their compliance with capital and leverage requirements.

**52. The NBB uses for its LSI supervision the SSM supervisory review and evaluation process (SREP) methodology.** The SREP methodology is structured around four key elements: i) business model and profitability assessment, ii) internal governance and risk management assessment, iii) an assessment of risks to capital and excessive leverage, iv) and an assessment of risks to liquidity and funding. The outcomes of these four elements lead to an overall SREP assessment, which serves as the basis for a range of supervisory actions. The NBB conducts a comprehensive SREP assessment covering all material risks at least every 3 years. However, for HI LSIs the comprehensive assessment is conducted annually. If an institution is not part of the annually planned comprehensive SREP assessment, its SREP will get updated offsite based on the available information.



**53. For the SREP risk assessment, the NBB uses the SSM tool to assign risk scores per SREP element and the overall SREP score.** The possibility is foreseen to consider certain risks as immaterial. The option to apply a simplified approach to some material risks is also foreseen, but hasn't been used until now by the NBB. The SREP tool results in a global risk score per LSI (1 – 4). For the calculation of the Pillar 2 requirement (P2R), the NBB uses its own excel tool that calculates per risk element a capital add-on. NBB offsite supervisors are responsible for the SREP, and take into account prudential reporting, received LSI documentation, the findings of the on-site inspections, and other relevant NBB documentation (e.g., horizontal thematic reviews) when scoring the different elements.

**54. The baseline supervisory work for the LSIs is determined based on the SREP, while the planning of the onsite work takes a wider range of considerations into account.** The SREP score determines the baseline planning of meetings and frequency of the assessment of: i) the financial statements and audit reports; ii) bank's internal risk report; iii) the recovery plan; iii) the management body; iv) the management body in its supervisory function; v) senior management; vi) internal audit; vii) external auditor; viii) risk assessment frequency, and; ix) SREP frequency. Taking into account the SSM priorities and planned benchmarking exercises, NBB priorities (from its Annual Risk Review), and the SREP scores, the offsite and onsite annual planning for the LSIs is further completed.

**55. Apart from the SSM priorities, it should be noted that the SSM/ECB is regularly performing horizontal thematic reviews and benchmarking exercises across all SSM jurisdictions.** These reviews on the one hand help to get a good overview of certain

developments, risks and supervisory practices across the SSM, and to share best practices and work to promote convergence of practices. Over the past few years, the SSM conducted among others thematic reviews of: i) credit underwriting standards of LSIs; ii) material growth of LSIs; iii) financial holding company structures; iv) annual LSI horizontal SREP review; v) COVID-19 vulnerability analysis and follow credit risk workshops with the NCAs; vi) deposit platforms; vii) LSI governance. Thematic reviews on climate risk for LSIs, on national stress testing practices and on credit risk are expected to start in 2023.

**56. While there is some room for enhancing the monitoring of LSIs' internal capital targets, internal NBB reporting and SSM reporting is adequately organized.** For internal monitoring the NBB uses an excel based Quick Look Tool (QLT), which provides on a quarterly basis an overview of the key financial indicators of the LSIs and also flags whether or not certain ratios/developments have reached a level that requires SSM notification. The QLT reporting could be enhanced by adding banks' internal capital targets to the ratios monitored. On an annual basis the TB Department submits a presentation with a global overview and the SREP scores of the LSIs for approval to the NBB Board and the department uses a tracking template for monitoring the progress on the planning (e.g., progress on baseline and planned onsite inspections). In addition to the notifications, the NBB also provides the SSM with additional reporting (e.g., LSI annual report, monitoring of credit metrics, assessment of significance or additional ad-hoc reporting upon request).

## B. Supervisory Tools

### Supervisory Review and Evaluation Program

**57. The NBB should continue to ensure adequate prudential supervisory staffing for LSI supervision to avoid gaps in the supervisory work program.** LSI supervision staffing constraints have been visible in conducting the 2022 SREP exercise and in internal SSM benchmarking. As a result of some turnover of supervisory staff, and the resulting time needed to fill vacancies, the SREP reviews planned for 2022 were delayed to 2023. Also, the results of the internal SSM benchmarking point to staffing levels for LSI supervision that are below SSM average.

**58. The P2R appears well embedded in the supervisory processes and quantitative requirements have since 2022 been complemented with qualitative ones.** The NBB uses the SSM SREP methodology, but instead of an overall capital add-on complements it with an add-on per risk type. In addition, in line with SSM guidance the NBB has adopted since 2022 the approach to provide more qualitative recommendations and requirements to promote adequate risk management and oversight by the control functions.

**59. Until 2022 only limited number of LSIs received a P2G, but the NBB is in the process of adopting the SSM P2G approach in 2023.** The NBB is in the process of implementing the SSM 2022 SI P2G bucketing approach, which it has calibrated for Belgian LSIs. The revised approach is expected to result in more LSIs receiving a P2G.

**60. In certain instances, proposals for changes to P2R requirements could be better motivated.** In reviewing files (which generally cover the P2R adequately), the FSAP noted that in one instance changes to P2R changes could be better motivated by taking into account a wider range of information (e.g., views of rating agencies and other market participants) and also by explaining the link and potential implications that the change may have on the P2G.

### **Interest, Liquidity and Climate risk**

**61. The NBB carefully reviewed the main lessons learned from the recent banking sector turmoil (e.g., in the US and Switzerland) and how these are relevant for LSIs.** The review of IRRBB is well embedded in the supervisory approach and SREP. In response to the market events early 2023, the NBB also requested banks to regularly report the potential losses on held-to-maturity securities in case they would need to be sold against market prices. This is in particular relevant as most of the securities that are held by LSIs are not accounted for mark-to-market valuations.<sup>22</sup>

**62. The NBB is reviewing its approach to liquidity risk also taking into account that until now there is no consolidated experience of setting Pillar 2 liquidity requirements.** The recent market turmoil in the US and Switzerland has pointed the authorities to the necessity of reviewing this approach, which will also be further discussed in a Euro-Area context. Adequate monitoring of liquidity metrics is however in place.

**63. With regard to climate change the NBB is in the process of considering how this could be best taken into account in the risk assessment and SREP.** In developing its approach, the guidance issued by the ECB/SSM is taken into account.<sup>23</sup> To create awareness the NBB has conducted and will continue conducting climate change risk survey among LSIs. As a first step, the results of these surveys could feed into qualitative SREP requirements to further awareness and stimulate LSIs to consider the impact of climate change could impact their clients and as its own risks and business model.

### **Onsite Examinations**

**64. Onsite examinations focus to a large extent on governance, control functions and credit risk.** The governance inspections generally include a review of the risk, internal audit and compliance function, and to the extent practical also include AML/CFT aspects. The increased attention to governance is also recognized in the relatively recent ECB/SSM thematic review of NCA's work on governance. This responds to the recommendation in the previous FSAP to enhance the focus on risk management and control functions by strengthening the role of the board in its supervisory function. The adequate attention on governance, also mitigates to some extent the weaknesses in the governance framework discussed above.

<sup>22</sup> Only LSIs that submit consolidated reporting are required to use IFRS. All other LSIs are on Belgian GAAP (BGAAP).

<sup>23</sup> ECB, Guide on climate-related and environmental risks (November 2020).

**65. IT and cyber risk onsite examinations only took place the last 5 years at High Impact LSIs, while others were only subject to offsite review of provided information.**

Given the need for prioritization as a result of limited resources, non-HI LSIs are only subject to IT and cyber security risk reviews during the SREP process. In the context of the SREP the NBB sends out IT and cyber security risk questionnaires of which the results are reviewed offsite and where necessary (e.g., in need of explanation or challenging) complemented with a short visit of IT/cyber security supervisors. More resources allocated to LSIs could be required if these offsite reviews or other collected information point to the need for an onsite inspection. This aspect would also need to be also taken into account in the evaluation of the overall adequacy of resources for LSI supervision (see paragraph 55).

**66. The NBB should ensure consistent practices across departments for documenting key supervisory decisions related to onsite inspections and their recommendations.**

The results of an onsite inspection and potential remedial actions are elevated to the Board when there is a 4 score but could also be warranted in other situations.<sup>24</sup> Based on the onsite inspection findings and the resulting need for improvements, inspected LSIs submit an action plan to the NBB. In case the inspection found issues that pose a high risk, the NBB could use article 234 of the Belgian Banking Law and turn the action plan or a part of the action plan into a “remedial” action plan. From the documents reviewed during the FSAP it was however not evident that the significance of the institution (e.g., for HI LSIs) and repeat findings also were taken into account in deciding on the level of decision making (e.g., elevation to the NBB Board) and the remedial action process. The NBB should ensure that the practices for documenting the evaluation of an institution’s onsite inspection, the resulting action plan, and the approval of decisions for using or not using remedial actions should be more consistently embedded in the processes across the relevant departments.

### **Business Model Review**

**67. In discussions and file review the NBB demonstrated to have a good understanding of business models and incorporating any concerns in their supervisory approach.**

This observation is applicable to LSIs as well as TCBs. Where relevant the authorities were able to provide evidence of addressing business model concerns effectively and as a result were able to apply supervisory approaches resulting in orderly wind-down of activities of licensed banks as well as branches that decided to leave the market.

### **Conduct**

**68. The FSMA has a well-developed framework for product and conduct supervision of banks.** The FSMA has a well-developed MIFID risk assessment framework. For banks, the risk assessment brings together information on the size the retail investment activities/services, the scoring of the activities/services on the MIFID Cartography, review of relevant documents, and

<sup>24</sup> NBB has the practice of also scoring the individual findings and the overall result of an onsite inspection with a 1 – 4 score.

observed red-flags (e.g., client questions, number of complaints, news, whistleblowing, ombudsman). The key observations and results of the risk assessment could also be useful for the NBB in its LSI supervision, as some of the collected information could point to weak governance, compliance or to IT problems (e.g., downtime of systems and resulting customer complaints).

**69. The FSMA is working on the introduction of a Banking Oath.** A draft law has been approved by the Council of Ministers in April 2023 and has since been submitted to various bodies, including the ECB, and is under discussion in the Parliament. The Banking Oath will increase the awareness of individuals on their responsibilities and in the event of breaches they will be subject to disciplinary proceeding before the FSMA. The FSMA would also keep a register of disciplinary sanctions. The framework would make it more difficult for people that have been subject to disciplinary sanctions to continue a career in leading roles in the banking industry.