FSAP: Belgian financial sector (supervision) assessed by the IMF[1]

On 8 March 2018, the International Monetary Fund (IMF) published the Financial Sector Assessment Program (FSAP) report for Belgium after it conducted an analysis of the Belgian financial sector and Belgian financial regulations during the course of 2017. This is a five-yearly exercise for countries with a systemically important financial sector, such as Belgium. The last time Belgium was assessed was in 2012-2013.

This analysis forms part of the IMF's supervisory function, along with its missions under Article IV, involving an extensive analysis of the socio-economic policy of the Member State in question. An FSAP is a financial sector analysis by the IMF that considers three main topics.

First, it assesses the financial sector's resilience by trying to identify systemic risks and sources of potential financial contagion between the various components of the financial sector. An essential tool enabling the IMF to examine the financial sector's resilience is the stress test, in which the IMF assesses the influence of extreme macroeconomic shocks on the portfolio of banks and insurance companies, for example.

Second, the IMF also checks the quality of the supervisory framework. On the one hand, it examines the micro-prudential supervision framework where the Basel Core Principles for Effective Banking Supervision and the Insurance Core Principles set the standard. In 2017, in view of the size of the financial conglomerates in the Belgian financial sector, the IMF also examined the supervision of these *bancassurance* groups on the basis of the Principles for the Supervision of Financial Conglomerates. Another key element of the mission concerned macroprudential supervision which, since the financial crisis, has formed an integral part of prudential supervision. For Belgium, the 2017 FSAP was the first opportunity to obtain an IMF analysis of the National Bank's still quite new macroprudential policy, including the Bank's initiatives in the residential property sector. During this mission, the IMF also examined the way in which the Bank conducts the oversight of SWIFT[2].

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[1] This article is composed of excerpts from the 2017 annual report of the National Bank of Belgium ("*Report 2017 - Economic and financial developments, NBB, March 2018*), the FSAP results and recommendations published by the IMF on 8 March 2018 (*"Belgium : Financial System Stability Assessment", IMF, March 2018*) and the press release issued by the NBB at the time (*IMF stress tests confirm that Belgian banks and insurance companies are able to withstand severe shocks, NBB, 8 March 2018)*.

[2] SWIFT (Society for Worldwide Interbank Financial Telecommunication) is a limited liability cooperative company established in Belgium and specialising in the exchange of financial messages between financial institutions and financial market infrastructures.

Third, an FSAP also focuses on the crisis management arsenal, i.e. the set of tools available to a Member State to prevent and combat financial crises. To that end, the IMF conducts interviews not only with the supervisory authority but also with other crisis management players, such as the resolution authority (in Belgium, the Resolution College set up at the Bank) and the deposit guarantee system (in Belgium, the Guarantee Fund for Financial Services).

The FSAP generally comprises several missions. For instance, the IMF's visit to Belgium in 2017 included a brief preparatory mission and two detailed missions lasting two weeks each. During these missions, various IMF experts held interviews with the Bank, the Financial Services and Markets Authority (FSMA), the Federal Public Service (FPS) Finance, the Finance Office, the aforesaid crisis management players and a whole range of market participants.

The IMF also held meetings with the European Central Bank (ECB) and the Single Resolution Board (SRB), the authority responsible for the resolution of the leading banks in the euro area. With the entry into force of the first and second pillars of the banking union, the supervision and resolution framework became largely European. The ECB and the SRB are now responsible for the supervision and resolution of credit institutions deemed significant (significant institutions: SIs), under the single supervisory and resolution mechanism. It should be noted that an FSAP on the euro area as a whole was taking place in parallel with the Belgian FSAP. That exercise is very important in view of the banking union and the primarily European character of financial regulations in the European Union.

On completion of the Belgian FSAP mission, the IMF published its recommendations, in which it stated the entities to which those recommendations are addressed (e.g. the Bank, the federal government, the ECB) and the timescale for implementing them. These recommendations are not binding but they carry considerable weight. Thus, most of the recommendations resulting from the 2012-2013 FSAP on banking supervision were transposed into the Banking Law[3] and the Law of 25 April 2014 establishing the mechanisms of a macroprudential policy[4]. This concerns among other things the granting of the macroprudential authority mandate and the resolution authority mandate to the Bank, the introduction of preferential treatment for retail deposits in the event of bankruptcy, and the requirement whereby credit institutions must submit their strategic decisions to the supervisory authority for prior approval. Since the last FSAP, the supervision framework and the prudential regulations have therefore undergone radical change. The 2017 FSAP revealed the areas in which Belgium is on the right track and those where the situation could be improved.

Box 1 of this article reproduces the executive summary of the IMFs "Financial System Stability Assessment" for Belgium. The IMF stresses that the Belgian financial sector has become considerably more robust since the previous FSAP. The stress tests that the IMF conducted jointly with the National Bank and the European Central Bank show that the Belgian banking and insurance sector is able to absorb the risks of a simulated drastic deterioration in macro-financial conditions.

[3] Law of 25 April 2014 on the legal status and supervision of credit institutions and investment firms.

[4] Law of 25 April 2014 establishing the mechanisms of a macroprudential policy and laying down the specific missions devolved to the National Bank of Belgium.

Apart from this generally favourable assessment of the health of the Belgian financial sector, the IMF also mentions a number of challenges.

For instance, the IMF finds potential vulnerabilities in the Belgian residential property sector, associated with the current favourable economic conditions. In particular, the IMF notes the rising debt level of Belgian households. For that reason, the IMF expresses its support for the additional macroprudential capital requirement proposed by the National Bank of Belgium (NBB). That measure should cause the banks to strengthen their capital buffers in order to absorb any losses in their mortgage portfolio. The IMF also recommends simplifying the procedures for deciding on macroprudential rules in order to permit an effective response to macroprudential developments.

In addition, the IMF focuses on the development of a European Banking Union. In its view, until such time as the European Banking Union is completed (for instance, there is still no European deposit guarantee mechanism), prudential supervision at European banking group level must be accompanied by sufficiently robust prudential attention to the group's systemic subsidiaries. In the case of Belgium, that is important because a number of systemic subsidiaries have a significant position in the financial sector. In that context, the IMF also stresses that, during the transitional period to a full Banking Union, it is essential to maintain sufficient capital and liquidity at subsidiary level.

More details on the various recommendations may be found in the remainder of the "Financial System Stability Assessment" and in the three accompanying Technical Notes that the IMF published concurrently. Those Technical Notes concern 1) the supervision of the banking and insurance sector and financial conglomerates[5]; 2) the financial crisis management; and 3) the stress tests on the Belgian banking and insurance sector.

These IMF recommendations will influence on the agenda of the supervisory and regulatory authorities in the years ahead. During 2018, in consultation with the other Belgian authorities, the National Bank will take the lead in implementing the recommendations addressed to it.

EXECUTIVE SUMMARY from "Belgium : Financial System Stability Assessment", IMF, March 2018

Belgium's financial landscape has changed significantly since the global financial crisis (GFC). The banking system has contracted mainly because of restructuring operations in entities that received government support. Banks have adopted more traditional business models, with greater emphasis on domestic lending and deposit funding. The insurance sector has seen some consolidation and is gradually moving away from traditional insurance products towards asset management-type products. Cross-border financial linkages, while still significant, have declined and Brussels remains the home of globally significant financial market infrastructures (FMIs) and service providers.

These changes have enhanced the structural resilience of the financial system, but cyclical vulnerabilities are rising. Banks' reduced reliance on wholesale funding and smaller trading books, together with more limited interbank activities, have reduced the potential for highly disruptive market-liquidity risk spirals and contagion. However, a domestic cyclical upswing has been spurred by easy global financial conditions, and new risks are emerging. This is most evident in the real estate sector, where rapid growth in mortgage lending and declining lending standards have led to marked increases in household leverage and housing prices, with signs of moderate, overvaluation in residential properties.

The financial sector remains resilient in the face of the rising cyclical vulnerabilities, but there is a need for closely monitoring risks. Stress tests on banks and insurance companies confirm that they can absorb credit, sovereign, and market losses in the event of a severe deterioration in macro financial conditions. The risk of interbank contagion through direct exposures is low. Insurance companies are also generally resilient and the losses incurred by those that belong to banking groups do not threaten the soundness of those groups. Bank resilience reflects relatively healthy loan portfolios and limited exposure to market and liquidity risks, while insurance companies have sound solvency levels and reduced exposures to guaranteed rates. Nonetheless, there is a need to monitor carefully banks' capacity to cope with interest rate shocks, credit risk vulnerabilities in selected portfolios, and growing liquidity risk in insurance companies.

A mortgage-related macroprudential policy recently proposed by the NBB needs to be enacted promptly. Following rejection by the government of measures proposed by the National Bank of Belgium (NBB), a new measure has been identified, which should be approved promptly. Going forward, it will be necessary to revise the framework for macroprudential decision making to enhance NBB's ability to deploy cyclical macroprudential policies in a timely manner.

Financial sector supervision and crisis management arrangements have been upgraded markedly. The Single Supervisory Mechanism (SSM), responsible for over 90 percent of the Belgian banking sector assets, has made the supervision of Belgian significant institutions (SIs) more intrusive, forward looking, and effective. NBB has enhanced the supervision of less significant institutions (LSIs). Resolution planning for SIs by the Single Resolution Mechanism (SRM) and for LSIs by the NBB is progressing.

However, the transition to a full banking union must be carefully managed by national and European authorities. The implementation of complex institutional reforms at different speeds may create unintended financial stability risks. While these risks are common to all euro area (EA) member countries, some are heightened in Belgium given the local presence of large subsidiaries of EA banks. Sufficient capital and loss absorbing capacity should be kept in these subsidiaries to ensure the viability of group resolution strategies.

NBB and European authorities should continue to upgrade their supervisory and crisis management frameworks and operational capacity. Efforts to ensure prudent provisioning practices and to enhance the monitoring of banks’ internal models should continue. Authorities should improve their ability to prepare for and manage a crisis by prioritizing the resolution planning for important banks and strengthening the deposit insurance system (DIS). It will also be important to address the challenges posed by complex financial conglomerates, ongoing changes in the risk profile of the insurance sector, and potential challenges arising from the low quality of some insurers’ capital.

The oversight arrangement for the Belgium-based Society for Worldwide Interbank Financial Telecommunication (SWIFT) has proven effective, but is being challenged by new risks. Key among these are cybersecurity incidents in SWIFT’s global user network. To strengthen the NBB's ability to exercise its role as overseer and protect Belgium's reputation as a key hub for FMIs, the authorities should consider complementing the NBB’s use of moral suasion with regulatory and supervisory powers and should enhance the NBB’s ability to share information with foreign authorities.

Belgium should continue efforts to enhance the effectiveness of its anti-money laundering/countering the financing of terrorism (AML/CFT) framework. The 2014 Financial Action Task Force (FATF) evaluation found a well-established regime, notwithstanding some deficiencies. Since then, steps have been taken to strengthen the framework, notably with respect to combating the financing of terrorism and AML/CFT supervision. However, efforts need to continue to fully implement the FATF’s recommended actions.

Main Recommendations	
Recommendation	**Timing***
Systemic risk analysis	
Enhance the risk analytical framework by: (i) incorporating bank stress testing to the toolkit for systemic risk assessment and macroprudential policy; (ii) extending the horizon of insurance stress tests; (iii) intensifying monitoring of insurers' mortgage loan portfolios and related underwriting standards; (iv) in cooperation with the FSMA, further developing the shadow banking monitoring framework; (v) enhancing the coverage and quality of commercial real estate data. (NBB)	ST
Prudential policy, supervision, and oversight	
Approve promptly the new macroprudential measure proposed by the NBB and enhance the NBB's ability to implement cyclical macroprudential tools in a timely manner. (MoF)	ST
Continue to strengthen bank supervision by: (i) ensuring the reliability and consistency of internal models and (ii) proactively assessing loan classifications to ensure prudent provisioning practices. (NBB/SSM)	C
Adjust to insurers' evolving risk profiles by: (i) seeking to address the sector's increasing liquidity risk; (ii) continuing to analyze the business growth of reinsurance operations; and (iii) engaging with the industry to gradually improve the quality of insurers' capital. (NBB)	ST
Enhance FC supervision by: (i) setting supervisory expectations for FC governance and risk management; and (ii) enhancing monitoring of intra-group transactions at FC level and the risk of regulatory arbitrage between insurance and banking sectors. (NBB/SSM)	ST
Enhance SWIFT oversight by (i) aiming at complementing the NBB's use of moral suasion in the oversight of SWIFT with additional regulatory and supervisory powers; (ii) broadening membership in the SWIFT Oversight Forum; and (iii) improving information sharing on SWIFT oversight and assurance reports.(NBB)	ST
Financial safety net and crisis management	
Ensure the feasibility of resolution strategies for banking groups with systemically important subsidiaries (SRM) and prioritize resolution planning for the two less significant institutions with the highest share of insured deposits (NBB).	MT
Strengthen the DIS by (i) publicly committing to shortening the DIS pay-out period to seven days by 2019; (ii) establishing credit lines with the MoF; and (iii) segregating the Guarantee Fund from government funds. (MoF)	ST
AML/CFT	
Ensure adequate transparency of beneficial ownership of legal persons and arrangements. (MoF)	MT

* C = continuous; I = Immediate (within one year); ST = Short Term (within 1-2 years); MT = Medium Term (within 3-5 years)