



Borrowing from the National Bank: how does it work?¹



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ABSTRACT

A national bank would not be a bank if it could not lend money. Indeed, only a commercial bank can take out a loan from the national bank, but other than that, the process is not that much different from when you as an individual take out a loan from a commercial bank. To take out a loan from a national bank, you would also need collateral, independent third parties and - as for all financial institutions - risks are controlled to a maximum.

The idea of borrowing from the National Bank probably never crossed your mind. Indeed, individual citizens cannot apply to the National Bank for a loan. You would need to turn to a commercial bank for that. However, commercial banks may also wish to borrow – for monetary policy purposes, for example – and it is the National Bank’s door they come knocking on. For such an application to be granted, two requirements must be met: the commercial bank must have a banking license and it must be able to provide collateral. This article focuses on the latter.

When you take out a loan to buy a home, your bank requires a guarantee, generally in the form of a mortgage on the property you wish to purchase. Thanks to this guarantee, the bank is sure to be able to recover the money it lends if you fail to pay back the loan. It is exactly the same when banks wish to borrow from the National Bank of Belgium (NBB): the NBB asks them to put up collateral.

¹ This article was published in the NBB-blog (13 October 2022).
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A wide collection of collateral

Are all forms of collateral the same? Not quite, because the NBB does for example not accept individual mortgages as collateral. Roughly speaking, the collateral accepted by the NBB can be divided into two categories: marketable and non-marketable assets.

Marketable assets are products listed on a stock exchange. Bonds are a good example. However, not all marketable assets are accepted as collateral by the NBB. A long list of strict conditions must be met. To provide clarity in this regard, the NBB (together with other central banks in the euro area) keeps a list of all marketable assets it accepts as collateral, of which there are currently 26,363.

The second category consists of **non-marketable assets**. These are primarily bank loans (in particular, loans extended by banks to the public sector and to businesses). Provided the appropriate conditions are met, such loans may also be used as collateral when borrowing from the NBB.

How much can a bank borrow?

When a bank in possession of the necessary collateral applies to the NBB for a loan, one important question remains: how much can it borrow? To determine this amount, the NBB calculates the value of the collateral on the table. In doing so, it distinguishes between marketable assets and non-marketable assets. The value of all authorised marketable assets is recalculated each day at ECB level. Regarding non-marketable assets, the NBB determines their value itself, an operation it also performs on a daily basis for all bank loans used as collateral.

A different kind of notary

In the preceding paragraph, we touched on the procedure without going into detail. When we say that a bank in possession of the necessary collateral can apply to the NBB for a loan, what exactly do we mean and how does it work?

Here again, we can refer to our earlier example in which you apply to a bank for a loan and take out a mortgage to secure it. In that example, a notary or solicitor is involved to formalise the mortgage and enter it in a central register. It's much the same when the NBB extends a loan. The main difference is that when a bank approaches the NBB with marketable assets as collateral, a so-called central securities depository (CSD) is involved instead of a notary. These entities keep a record of who holds which marketable assets. When a bank pledges marketable assets to the NBB as collateral, it must inform the CSD responsible for managing the instrument in question. The CSD then confirms this information to the NBB. In this way, a neutral counterparty keeps an eye on marketable assets pledged to the NBB.



The situation is different for non-marketable assets, such as bank loans. There is in fact no neutral intermediary responsible for managing this type of collateral. Therefore, the commercial bank and the NBB have a direct relationship. The absence of a neutral intermediary gives rise to additional risks, meaning the NBB carries out additional checks. A pledge of bank loans, as opposed to marketable assets, to the NBB as collateral is therefore a more cumbersome process.

What if things don't go as planned?

Anyone who lends money hopes to get it back sooner or later. But the financial world doesn't feed on hope, which is why it requires collateral. If a bank is unable to repay a loan, the collateral it pledged is realised and sold, thereby allowing the NBB to recover the funds it lent.

Belgium has not seen such severe conditions since the 2008 financial crisis. Our colleagues responsible for supervising the sector are doing their utmost to prevent another worst-case scenario. However, if it ever comes to pass, you should know that the NBB's financial position is protected through sound management of collateral on a daily basis.