THE FUTURE OF THE BELGIAN FINANCIAL SECTOR

REPORT OF THE HIGH LEVEL EXPERT GROUP ESTABLISHED ON THE INITIATIVE OF THE MINISTER OF FINANCE OF BELGIUM

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Mission of the HLEG

On April 29th 2015, Minister of Finance Johan Van Overtveldt announced the establishment of a High Level Expert Group on the Future of the Belgian Financial Sector. The High Level Expert Group’s mandate is to evaluate and reflect on the current position of the Belgian financial sector by identifying the main challenges the sector is facing following the financial crisis and by exploring the long-term prospects for the sector.

The High Level Expert Group consists of eight leading and complementary experts in the field of finance and economics.

The Expert Group was asked to examine and make recommendations on three issues:

A. Creating a robust, sustainable financial sector
B. The role of Brussels as a financial centre
C. Tax and regulation related to the financial sector

Composition of the HLEG

Members

André Sapir (Chairman)
Mr Sapir is an Economics professor at the Free University of Brussels (ULB) and Senior Fellow at Bruegel. His extensive research experience includes finance and monetary policy. He was Chairman of the Advisory Scientific Committee of the European Systemic Risk Board based at the ECB in Frankfurt.

Geert Noels (Vice-Chairman)
Mr Noels was a member of the Lamfalussy Committee (2008-2009), the forerunner of the HLEG. He is an economist who has been working for 25 years in research departments in the private sector.

Jean-Pierre Blumberg
Mr Blumberg is a partner at the law firm Linklaters and a member of its Board of Directors. He is a lecturer at the University of Antwerp and independent director of a number of listed companies. He specialises in mergers & acquisitions and is currently a Co-head of Global M&A at Linklaters.

Luc Coene
Mr Coene was Governor of the National Bank of Belgium (NBB). He is currently a member of the Supervisory Board of the ECB in Frankfurt. He led the restructuring of the Belgian financial sector during and after the crisis.

Tom Dechaene
Mr Dechaene is a Director at the NBB. He has had a wide-ranging career in the financial sector in both London and Belgium, as a commercial banker, investment banker and non-executive board member.

Lex Hoogduin
Mr Hoogduin is Chairman of LCH.Clearnet and Economics professor at the University of Groningen. He is a former Executive Director at the Dutch Central Bank and advisor to the President of the ECB.
Paul Jorion
Mr Jorion is by training an anthropologist, sociologist with a special interest in the cognitive sciences. He has also written eleven books on capitalist economics. He has worked in the US in the financial sector. Mr Jorion has had an extensive academic career.

Lieve Mostrey
Ms Mostrey has had a long career in the financial sector at key decision-making levels, and is currently working for Euroclear as Executive Director and Chief Technology and Services Officer.

Rapporteurs

Marianne Collin
Ms Collin is a senior advisor at the NBB’s Prudential Policy Department. She has extensive experience in regulation, supervision, the Belgian financial sector and especially government participations and macro-prudential policy.

Hans Dewachter
Mr Dewachter is a senior advisor at the NBB’s Research Department and a professor (part-time) at the University of Leuven. His research concentrates on the link between macro-economics and finance.

Anthony De Lannoy
Mr De Lannoy has been a researcher at the NBB, tackling international financial problems and worked at the IMF. He is currently seconded to the Cabinet of the Minister of Finance.
Executive summary

- **REFORMS OF THE SUPERVISORY AND REGULATORY FRAMEWORK AFTER THE CRISIS HAVE MADE THE FINANCIAL SYSTEM MORE RESILIENT BUT NEW RISKS ARE EMERGING.**
- **TO ACHIEVE STABILITY AND GROWTH, THE FINANCIAL SYSTEM HAS TO BE RESILIENT AND THE FINANCIAL SECTOR MUST BE COMPETITIVE AND EFFICIENT AND ENJOY THE CONFIDENCE OF CONSUMERS. THAT IS THE CENTRAL GUIDELINE IN THE 10 RECOMMENDATIONS THAT THE HLEG PROPOSES.**
- **THE HLEG DID NOT EMBARK ON A JOURNEY TO FORMULATE A WISH LIST OF TAX MEASURES AND INCENTIVES THAT COULD DISTRACT FROM REQUIRED LONG-TERM STRUCTURAL POLICY MEASURES**
- **RECOMMENDATIONS FOCUS ON NEW CHALLENGES, RISKS AND OPPORTUNITIES. LOW INTEREST RATES, COUNTERPRODUCTIVE EFFECTS OF TAX INCENTIVES AND CYBER SECURITY ARE IMPORTANT RISKS. GOLD-PLATING IS AN IMPORTANT NEW ISSUE, AND AN ELEMENT IN A COMPREHENSIVE POLICY TO IMPROVE BRUSSELS AS A FINANCIAL CENTRE, WHERE DIGITISATION BUT ALSO HIGH ETHICAL STANDARDS HAVE TO PLAY A KEY ROLE.**
- **A PERMANENT DISCUSSION PLATFORM FOR THE FINANCIAL SECTOR INVOLVING ALL THE RELEVANT STAKEHOLDERS SHOULD BE CREATED**

Background of the mission

1. The **global financial crisis** in 2007 and 2008 had major consequences on the financial sector, especially in Belgium, leading to the massive support of the State. The cost of this crisis to the real economy has been significant, and the impact is still visible today. Eight years after the financial crisis, the financial system and especially the banking industry, in Belgium and worldwide has been undergoing important transformations but it has still not fully recovered in view of the remaining legacy of the financial crisis and the challenges posed by the current environment.

2. It is against this background that the High Level Expert Group (HLEG) conducted its analysis and recommendations in response to the Minister of Finance’s decision to evaluate and reflect on the current position of the Belgian financial sector by identifying the main challenges the sector is facing following the financial crisis and by exploring the long-term prospects of the sector. In particular, the HLEG was asked to examine and make recommendations on three key issues:

   A. Creating a robust, sustainable financial sector

   B. The role of Brussels as a financial centre

   C. Tax and regulation related to the financial sector

3. For more than half a year, the HLEG has been analysing the Belgian financial sector in an international context. The Group has collected a lot of factual information about the Belgian financial sector and received many suggestions from financial experts and stakeholders as well as from the social partners for improving the state of the financial sector in Belgium. The HLEG thanks all these parties for their valuable contributions.

Recent developments in the Belgian financial sector

4. While the Lamfalussy report (2008-2009) focused mainly on the causes of the financial crisis and the remedies mainly from a point of view of prudential regulation and supervision, the current report - 7 years later - aims at evaluating the reforms and addressing remaining challenges for the financial sector to protect the economy from a repetition of a financial crisis with extreme consequences such as experienced
previously, while proposing at the same time avenues to increase the competitiveness and efficiency of the financial sector as a whole in a general objective of supporting economic growth.

5. Significant changes in the financial intermediation environment have taken place since the outbreak of the financial crisis in Belgium. The capital and liquidity position of Belgian banks has been significantly improved. The Belgian financial system has retrenched its activities to its core business activities and markets, reduced somewhat its complexity and adapted their risk-taking behaviour, although further adjustments might still be needed.

6. This downsizing and deleveraging of the banking activities went together with an increase in the non-bank and in particular the so-called shadow banking activities, leading to some diversification of the funding sources and instruments but also to potential risks which will need to be monitored. This retrenchment was initiated by the restructuring plans imposed by the EC as a consequence of State Aid to the financial sector.

7. Despite important restructuring and deleveraging, the financial sector continues to support the funding of the Belgian economy, albeit with less appetite for risky and long-term projects. The financing of a SME-dominated economy remains to a large extent driven by financial intermediation and in particular banks rather than by direct financing through capital markets.

8. Direct access to capital market finance remains mainly restricted to larger companies. Efforts to open up capital markets to SMEs have so far not been very successful in Belgium. The Capital Market Union could therefore be an opportunity for Belgium.

9. Belgian households and to a lesser extent non-financial corporations continue to have strong liquidity preferences in their investment profiles, creating a surplus liquidity/savings at the level of the Belgian economy. The current favourable tax treatment of this type of savings instruments further encourages investment biases towards regulated saving accounts, at the expense of more long-term and/or more risky investments. Furthermore this fiscal incentive has a potential moral hazard risk for the government.

10. Eight years after the outbreak of the financial crisis, the macro-financial environment is characterized by a persistently low (potential) growth and low inflation as well as historically low levels of nominal interest rates and global risk premium compression. This situation creates challenges for the financial industry and implies potentially new downside risks to the sector in case of renewed financial stress.

11. Reforms of the supervisory and regulatory framework have made the system more resilient. Yet the impact of all these reforms on the business model of financial operators and on the real economy still remains partly unknown.

12. Financial institutions’ profitability, their liquidity and solvency position improved in recent years, but major challenges remain to maintain a sustainable and realistic level of profitability. Insurance companies are particularly vulnerable to persistent low interest rates.

13. Modernization of IT systems and the revolution stemming from digitisation of the financial institutions constitute a key challenge in view of the implications for processes, operations and (customer) services in the financial industry. It will lead to substantial investments and increasing competition from non-traditional players putting additional pressure on short-term profitability.
14. Digitization is increasing **cyber risks**. Cyber security is no longer a pure ICT problem. Cyber incidents could have even a systemic impact due to interruption of certain financial processes and/or the public loss of confidence in the integrity of a particular systemic financial institution or the whole system.

15. Regulatory reforms for financial market infrastructures have made them safer, but important new challenges arise with the entry of new (non-traditional) players, increasing interconnectedness and cyber risks.

### Current environment and consequences

16. All these elements – and in particular, surplus liquidity, extremely low interest rates and lower profitability – form a challenging environment for the authorities to avoid a repetition of the derailment in the past (**search for yield**). Structural reforms implemented in Belgium hinder the “search for revenue” from trading activities – especially proprietary trading – for banks but other type of risks could emerge.

17. The development of **shadow banking activities** (e.g. fund industry) reflects this phenomenon. While these activities contribute to the diversification of the financial sector, it also leads to complexity and opacity in the financial system.

18. The **real estate market** in Belgium has been very buoyant in the past 20 years. Household debt has increased, reaching currently almost 60% of GDP. That is close to -but below- the euro area average. Although Belgian credit institutions have applied fairly prudent credit standards to mortgage loans compared to other countries, some sub-segments of their outstanding mortgage portfolios are exposed to relatively high-risk levels. This situation could lead to important losses for Belgian credit institutions in case of a severe downturn in the Belgian real estate market.

19. **Consumer protection** has been reinforced in view of both the complexity of financial products and the weaknesses observed in the past. An adequate level of consumer protection is crucial to ensure and maintain confidence in the financial sector. In this context, the different reforms – the so-called MIFID – have been progressively introduced. **MIFID** has become administratively complex. An adequate level of financial education and sufficient ethics at the level of financial institutions should be promoted.

### Recommendations

20. Based on these observations, the HLEG makes **10 recommendations** to enhance the resilience and competitive position of the Belgian financial sector. The recommendations reflect the assumption by the HLEG that the objective of the Belgian public authorities towards the Belgian financial sector is to ensure that it operates **at the service of the Belgian economy and society by helping to deliver stable and sustainable growth**.

21. To achieve stability and growth, the financial system has to be resilient and the financial sector must be competitive and efficient. Financial resilience is more important than just financial stability and implies that the financial system should be robust and be able to absorb shocks. Provided the system is resilient, there should be no trade-off between measures to promote competitiveness and financial stability.

22. The HLEG wants to stress that the Belgian public authorities should provide **more long-term stability** to the legal, prudential and tax framework, which would make Belgium and Brussels more attractive and more
competitive for financial activities. Also, the Belgian public authorities can take certain steps to improve the financial ecosystem in Belgium and in Brussels in particular.

23. The HLEG did not embark on a journey to formulate a wish list of tax measures and incentives that could shortcut needed long-term structural policy measures. This would make our report vulnerable for lobby pressure, but most importantly, would be unrealistic in current budgetary circumstances. The common denominator in all the hearings we had with members of the financial community is the primacy of tax stability over tax incentives.

24. Although major reforms have already been introduced to enhance the resilience of the financial system, some risks remain, especially if low interest rates would persist for some years. The first 5 recommendations address this issue. Recommendation 1 proposes to enhance the current regulatory and supervisory framework. Recommendation 2 proposes to enhance the resilience of the real estate market. Changes to the tax treatment of financial assets are proposed in recommendation 3 to eliminate existing distortions and achieve better functioning and more balanced financial markets. Enhancing resilience also implies mitigating excessive risk-taking behaviour and better risk management, an issue addressed in recommendation 4. Finally, recommendation 5 proposes to assess at regular intervals the risks of the financial sector for public finances.

25. The HLEG underlines that an adequate level of consumer protection is essential to safeguard confidence in the financial sector. Consumer protection is addressed in different recommendations which aim to enhance the current regime by improving the quality of the information, reducing conflict of interests, improving remuneration practices and by making the system – especially for payments - more resilient to cyber risks.

26. The HLEG is convinced that opportunities exist in Belgium and can be seized to further promote the current strengths and expertise and the development of a sound and diversified financial system. Certain products or investments are still lacking and specific challenges such as the technological revolution, low interest rate environment and ageing population will need to be urgently addressed. The next 5 recommendations aim at supporting the missing channels in the Belgian financial system and improve its competitiveness. Competitiveness raises the issue of effectiveness and productivity of the financial sector. It also demands a greater variety of financial instruments and intermediaries to channel savings supplies to investment demands, especially in the context of ageing and surplus savings in Belgium. These issues are addressed in recommendation 6. Competitiveness raises the issue of imposing higher burdens on the national financial industry than what is agreed at the European level. The issue of gold plating is addressed in recommendation 7 by providing some guiding principles to the Belgian authorities. Competitiveness also means that Belgium should be at least at par with its neighbours in terms of digital transformation and cyber security. Recommendations 8 and 9 make a number of specific proposals in this respect. Finally, recommendation 10 makes general proposals for the management by the Belgian State of its participations in the financial sector.

27. In addition to these recommendations, the HLEG calls for the establishment of a permanent discussion platform for the financial sector involving all the relevant stakeholders. The goal of the platform should be to exchange views about the business and regulatory environment and the financial ecosystem in Belgium. One of the first tasks of the platform should be to discuss the recommendations of this report.

28. The present report reflects the unanimous view of the Group’s members.
Part 1: The Belgian financial sector: eight years after the financial crisis

1. Supervisory and regulatory reforms

1. The recent financial crisis has resulted in massive state interventions and significant losses of social welfare. The causes of the financial crisis were multiple: inappropriate regulatory and supervisory framework, excessive leverage and risk taking, economic imbalances, lack of ethics. In response to this unprecedented financial crisis, much-needed and important reforms of financial supervision and regulation have been introduced. All reforms have not yet been fully implemented, but higher and better quality capital and liquidity requirements have increased the resilience and robustness of the financial sector.

2. Supervision has been radically reformed since the onset of the financial crisis. At national level, the implementation of the “twin peaks” model on 1 April 2011 brought fundamental changes to the supervision architecture by transferring the micro-supervision of banks, insurance and market infrastructure to the NBB after a short transition period with the establishment of the reinforced cooperation model (CREFS) as proposed by the Lamfalussy Report.

3. This new framework improved the coordination and integration of micro-prudential and macro-prudential policies within the NBB. The supervision has evolved from a more rule-based towards a risk-based and intrusive approach. The NBB has been given a mandate to maintain financial stability as a whole and has been granted a wide range of powers, including macro-prudential instruments, issuing recommendations to and collecting financial information from banking, finance and insurance entities, even those not directly under its supervision too.

4. The FSMA is now responsible for the integrity of the financial markets and fair treatment of financial consumers, competences that have received more attention since the financial crisis.

5. At European level, implementation of an integrated financial framework – the banking union – in 2014 has been the most important reform, further completing the Economic and Monetary Union since the European System of Financial Supervision (ESFS) was set up in 2011.

6. The banking union is an important step forward in euro area governance designed to reduce the negative self-reinforcing interactions between the public sector and the banking sector and limit the fragmentation of markets.

7. The first pillar - the Single Supervisory Mechanism (SSM) – is a key component because euro area banks operating within a financially integrated market have sizeable cross-border activities. Extending bank supervision beyond domestic borders is therefore crucial to align responsibilities and ensure coherent and harmonised implementation of supervisory and regulatory practices.

8. The SSM could not be coherent without a single resolution authority (second pillar) and a common deposit guarantee system (third pillar). The absence of a central resolution authority – with a single resolution fund – could once again destabilise confidence and strengthen the link between banks and

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1 It includes the European Systemic Risk Board (ESRB), an European macro-prudential supervision body, and the European Supervisory Authorities (ESAs) responsible for improving micro-prudential supervision in Europe in the three sectors: banking, insurance and securities markets.
public debt. In view of the sheer size of cross-border groups, a single resolution authority tends to be more effective than a multitude of uncoordinated national authorities and has the advantage of limiting the negative externalities resulting from individual domestic measures, such as those seen at the time of the resolution of large European cross-border groups during the financial crisis. It also aligns the responsibilities of supervision and resolution at the same level. This is particularly important for Belgium in view of the cross-border dimension of the banking industry. The recent financial crisis highlighted how damaging the retrenchment of national authorities can be for smaller countries with limited fiscal capacity. A single resolution authority with a single resolution fund has now been set up, but will not be fully operational for another 8 years. The European Commission’s recent proposal for a common deposit guarantee system would fill in the missing pillar.

9. The financial crisis highlighted the fact that safeguarding the financial position of individual institutions was not sufficient to preserve stability of the financial system at the macro level. In a context of global markets, the interactions between financial intermediaries can rapidly trigger contagion which will spread all the faster if the main market players have adopted similar strategies or identical positions. In this context, micro-prudential supervision has been complemented by macro-prudential policies both at the national and European level. The NBB is responsible for macro-prudential policies at national level, while the ECB has been given some competence in the context of the banking union and the ESRB has maintained its oversight function for the EU financial system.

10. While this new supervisory structure opens up major opportunities, it might also raise some challenges.

i. First, it creates a relatively complex structure of supervision involving a lot of different authorities. Close cooperation and collaboration is therefore required to ensure efficient supervision.

ii. Second, in view of the large number of banks supervised by the ECB, there might be a risk of more compliance-based supervision.

iii. Third, centralised supervision might create the risk of a “one size fits all” supervision and as a result, a less diversified banking sector.

iv. Fourth, while harmonised supervision might help ensure a level playing field, it could also facilitate – inter alia with the harmonisation of the regulatory framework – financial sector concentration for instance by encouraging M&As and as a result, increase the risk of ‘too-big-to-fail’ institutions, especially in the context of pressures on profitability.

v. Finally, unified supervision enhances the centralisation of capital and liquidity within cross-border groups, without yet having a full banking union, especially a common deposit guarantee scheme and a wider fiscal union. This could generate some risks for Belgium, which has persistent surplus savings.

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2 The ECB can only impose more stringent requirements foreseen in the EU legislation and the competences are limited to banks.
11. The regulatory framework has been considerably enhanced and strengthened in view of significant weaknesses observed during the financial crisis not only for banks but also for insurance companies and financial market infrastructures. These changes are designed to establish a structure that is more capable of safeguarding financial stability, to improve governance in the financial sector at international and national levels and to restore confidence in financial intermediaries. New requirements have been introduced in terms of capital and liquidity as well as for governance – including remuneration. Crisis management measures have also been developed in order to reduce the probability of State intervention in the future. It is nevertheless important to acknowledge that even though burden-sharing principles (e.g. bail-in instruments) have been introduced in the new framework, bail-out might not be ruled out altogether, especially in the event of a systemic crisis. The door for bail-in has been opened, but the back door for bail-out has not been closed at all. Much will depend on the “systemic” nature of the shocks or market failure.

12. Additional or more stringent regulatory reforms have been implemented in Belgium with the new Banking Law in particular in the field of governance and trading activities for credit institutions. These two elements were considered by the Belgian authorities as major sources of financial instability. But in some cases, the reforms might generate potential negative effects for financial institutions in view of the lack of a level playing field. In any case, the risks generated by trading activities were largely underestimated before the financial crisis. Banks’ risk management was relatively poor and capital levels were not in line with the intrinsic riskiness of these activities and as result, capital buffers were not sufficient to absorb losses.

13. While all these reforms have made the system more resilient, the combined impact of all these measures is not yet clear on banks’ and insurance companies’ business models and on the real economy. Implementation of forthcoming reforms, especially the Minimum Requirement for Eligible Liabilities (MREL), Net Stable Funding Ratio (NSFR) and leverage ratio, is crucial but also challenging. Additional regulatory reforms discussed in Basel – in particular on sovereign exposures, the review of internal models and the standardised approach – are currently envisaged and could result in substantial additional capital requirements for some institutions or business models. This envisaged reform – which needs to be finalised - will need to be carefully calibrated.

14. Important financial market infrastructures are located in Belgium. Recent reforms, in particular EMIR and CSDR, will have quite a big impact on business requirements and their operational processes. But they might also offer some new opportunities for instance in terms of collateral management services.

15. The introduction on January 1 2016 of the new Solvency II regulatory framework will constitute a major challenge for insurance companies – coming on top of the unfavourable financial environment – and might increase balance sheet volatility. The very long transition period (16 years) should mitigate the impact of the

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3 Setting up recovery and resolution plans, harmonisation of resolution instruments (e.g. bail-in,…).
4 Law of 25 April 2014 on the legal status and supervision of credit institutions.
5 This requirement will be imposed by the resolution authority to ensure that banks have enough liabilities that could be bailed in in the event of failure.
6 European Market Infrastructure Regulation. This Regulation requires all (European) derivative transactions to be reported to trade repositories, accessible to supervisory authorities. In addition, EMIR requires standard derivative contracts to be cleared through central counterparties (CCPs) and establishes stringent governance (organisational, business conduct) and prudential requirements for these CCPs. In August 2015, the European Commission adopted a Delegated Regulation which provides for mandatory clearing for certain over-the-counter (OTC) interest rate derivative contracts through central counterparties.
7 Central Securities Depositories Regulation. This Regulation aims at improving securities settlement in the European Union. It introduces “an obligation for the dematerialisation of most securities, harmonised settlement periods for most transactions in such securities, settlement discipline measures and common rules for central securities depositories (CSDs)” (EC).
reform but might also lead to regulatory complacency and reduce incentives for insurance companies to enhance their financial position and review their business models. Although the reform should boost insurance companies’ resilience, it will also lead to more complexity for both companies and regulators.

16. Consumer protection has been reinforced in view of the complexity of financial products as well as weaknesses observed in the past. An adequate degree of consumer protection is crucial to ensure and maintain confidence in the financial sector, which is why all the various reforms have been introduced only gradually. The legislation behind these reforms, the Markets in Financial Instruments Directive (MiFID) has become highly complex; it is important to back it up with an adequate level of financial education and sufficient ethics at the level of financial institutions.

17. All these reforms aim are designed to enhance the resilience of individual institutions and the financial sector as a whole. However, the complexity of some of them and their interaction raise issues regarding the capacity of institutions to adapt their business models in a sustainable manner and the capacity of authorities to supervise simultaneously implementation of reforms, emerging risks and write-down of legacy activities. In some cases, regulations have been juxtaposed without a coherent framework.

18. These reforms have also reinforced the development of financial services activities outside the regulated financial sector, the so-called shadow banking sector. While this could help to the diversify funding and saving sources, it might also create new risks for financial stability through greater complexity, interconnectedness, lack of transparency and increased liquidity risks. This raises the issue of keeping some sub-sectors in a supervisory twilight zone.

2. A challenging macro-financial environment

19. The global macro-financial environment in which the Belgian financial sector operates is still suffering from the fallout from the financial crisis. Seven years on, the macro-financial environment is still characterised by persistently low (potential) growth and low inflation as well as historically low levels of nominal interest rates and global risk premium compression, although it appears that the trend has been reversed in the United States. External factors (oil prices, geopolitical risks, etc.), fiscal consolidation, weak or lagging implementation of structural reforms, population ageing, as well as unprecedented (conventional and unconventional) monetary policy actions in major parts of the world have played their role in impacting on this environment. Also, the European financial markets seem much more fragmented than prior to the crisis, currently leading to a lower degree of risk-sharing across countries and markets, despite the recent introduction of the new governance strategy in the euro area.

20. While some signs of improvement in the economic environment are starting to show – notably in economic activity – it is most likely that the financial and economic environment will remain difficult in the years to come, posing threats and challenges to the Belgian financial sector. These challenges impact either structurally on the sector or imply potentially new downside risks in the event of renewed financial stress (e.g. related to the search for yield and growth of the shadow banking sector). The vulnerability to downside financial risks occurs in a time frame where public finances have been severely stretched by the financial crisis, leaving little room for manoeuvre and/or shock absorption capacity in the event of a new financial crisis. This not only applies to the capacity to “bail out” part of the financial sector but more generally
to the counter-cyclical shock absorption capacity. This caveat certainly applies to Belgium, considering its high public debt and the long-term challenge related to population ageing.

21. In particular, the low growth environment generates a potentially difficult situation as low (nominal and real) growth may be persistent and as a result weigh structurally on the profitability of the financial sector. According to the EC’s latest forecasts, the Belgian economy’s potential growth will stay around 1.2% until 2018, a significantly less optimistic estimate than the benchmark forecast close to 2% before the crisis. Low growth affects the financial sector through various channels:

i. First of all, the low growth potential may induce higher credit risk in the economy from the borrowers’ side and slow down deleveraging in the private non-financial sector. In this context, some deterioration in credit quality indicators is observed in the banking sector with, for instance, impaired loans increasing from around 2% of total loans to levels close to 4% during the post-crisis period. But credit quality of Belgian banks remains relatively sound compared to some EU countries after the deep restructuring and in view of relatively conservative loan standards. Even though impairments declined somewhat in 2014 and 2015, the prospect of the low growth environment having a further impact on loan portfolio credit quality cannot be ruled out.

ii. Secondly and more importantly, the low growth environment continues to weigh heavily on loan (investment) demand in the broad sense, reducing intermediation and eventually possibly profitability of the financial sector as a whole. The impact of this demand channel on profitability becomes all the more important considering that, in general, banks’ profits depend on net interest income. As a result of the banks’ deleveraging efforts, the share in profits of non-interest income dropped from 50% before the financial crisis to about 30% in 2014. Low demand and unfavourable interest rate developments (see below) can negatively impact on the profitability in the medium term and require banks to consider alternative ways to secure profitability either through increasing margins, aligning service tariffs on actual costs, cutting costs or changing business model by focusing more on fee and commission business.

22. The structurally low interest rate environment is currently a critical factor – probably the most important challenge – for the financial sector. In the medium term, this persistently low interest rate environment may weigh structurally on profitability of the financial sector as maturing high-yield portfolios would be replaced by lower-yielding portfolios, dwindling interest rate margins and/or widening gaps between contractually guaranteed and observed market yields and consequently undermining profitability and even solvency in the medium term.

23. Over time, these issues may come into play in particular for the insurance sector with a legacy of contracts at relatively high guaranteed interest rates as well as banks that rely increasingly on net interest income as their main source of profitability. The latest data available (2014) for the insurance sector imply an average guaranteed rate of return of 2.91% on “class 21” contracts, well above current market yields of government bonds. Although in the short term, capital gains on bonds already in insurance companies’ portfolios may compensate for falling interest rates, there is a real risk that in the longer run the effective return on (new) assets will not be sufficient to cover average guaranteed returns.

This tends to be confirmed by the recent profitability figures for life insurance companies, which turned negative in the first half of 2015. Similarly, banks increased profitability in 2014 and in the first nine months of
2015 (net interest income) on the back of declining short-term funding rates and the one-off impact of mortgage loan refinancing. However, with funding (including deposits) rates already close to zero, the effective interest margin on lending is likely to fall as maturing (high-yielding) securities are being replaced with lower-yielding ones, without further options for commensurate cuts in funding rates. Preserving sustainable profitability (and market-conform returns) in the medium term will be a major challenge for the financial sector. Return on equity in both the banking and insurance sector has fallen since the financial crisis with average ROE standing at 9.6% in the banking sector in 2015 and 5.1% in the insurance industry, compared to respectively 16% and 20% before the crisis (average over the period 2003-2007). Obviously, such levels of ROE were unsustainable. However, it is crucial to ensure ROE are above the costs of capital. Although some positive results might be expected in the coming months as banks tend to benefit from low interest rates on the liabilities side while still benefiting from higher interest rates on loans granted in the past on the assets side, profitability will be under strong pressure in the coming years if interest rates remain low and if no restructuring measures are taken by institutions to improve efficiency.

Moreover, the low interest rate environment has led to a strong compression of risk premiums in most financial markets especially in the most liquid market segments, worldwide but also in Belgium. Yields of benchmark sovereign and corporate bonds trade(d) at record low levels, sometimes even negative rates, while broad-based stock market indices – notwithstanding strong dividends – have seen higher asset prices on the back of the stimulating monetary policy. As a consequence of this substantial and broad-based risk premium compression, the low interest rate environment may become – and increasingly so – conducive to excessive financial risk-taking by the financial sector (also) in less liquid market segments, potentially resulting in the build-up of significant imbalances and increased sensitivity of the financial sector in the event of sudden reversals in risk aversion. This risk is even more pronounced in a context of low profitability. These imbalances could become more relevant in the case of impaired liquidity provision – or the occurrence of liquidity spirals– in specific parts of the secondary financial markets and may generate a need for adequate policies/contingency plans in managing liquidity crises. Although there are few signs of excessive risk-taking in the Belgian banking and insurance sector, it is harder to assess the overall imbalances and liquidity exposures of the non-bank sub-sectors.

While the banking sector has certainly become more robust since the crisis in terms of reinforced capital and liquidity buffers, there remain questions as to what extent the Belgian financial sector as a whole (and in particular non-bank segments set up mostly by banks in Belgium) is armed to accommodate significant drops in liquidity in specific segments of the financial market – such as the corporate bond markets and to a lesser extent the sovereign bond markets, especially as it appears that market makers that act as a first line of defence, are disappearing. If households would like to sell their shares in funds, asset managers might have difficulty in reimbursing their clients in a bear market and, as a result, banks might be forced to provide liquidity lines to the asset managers.

Financial risk-taking observed in financial markets does not necessarily lead to economic risk-taking (and hence productive investment). The investment activity (both public and private) of the Belgian economy remains relatively subdued. Combined with the low growth environment and uncertainties in the economic outlook, the need for deleveraging – either imposed by EU fiscal rules and some difficulty in financing larger (public and private) investments – has led to structurally weak investment demand from both the public sector and the corporate sector, leading to low levels of private and public investment. Over the past couple of years, public investment has not been sufficient to compensate for the capital depreciation. As a result, net investment by the general government sector amounted to -0.1% of GDP in 2014, while private
sector investment stood at 3.1% of GDP, which is well below its pre-crisis average (1999-2007) of 5.1% of GDP. There have been similar developments in the euro area, where private net investment was even lower in 2014 (1.9% GDP).

27. The Belgian economy still has to cope with the legacy of the financial crisis in the form of high private and public sector debt levels. Since the financial crisis, the debt burden (debt ratios) of the private and the public sectors has been increasing significantly in Belgium to reach elevated levels. Gross consolidated debt for the public sector will oscillate around 106% of GDP at the end of 2015, compared to 86.9% at the end of 2007, mainly as a result of specific post-crisis government policies and support as well as a lack of structural reform in the past. As a result of the massive state support, the Belgian authorities have introduced various taxes on the financial industry, especially on the banking sector (see table in annex). A similar upward trend has been observed for private consolidated debt which increased from 134% of GDP in 2007 to 185% in 2015Q2. Household debt has grown continuously to reach 58.8% of GDP in 2015Q2 compared to 46% end-2007, gradually narrowing the gap with the EA average and countries with debt sustainability problems. This increase mainly results from various favourable tax measures, rising house prices and low interest rates.

28. Even though in absolute terms the debt (service) burden of Belgian households remains manageable at this stage and is at the aggregate (macro) level backed by a large stock of financial assets, credit risks for specific (vulnerable) groups may be significant. These credit risks may be particularly relevant in the context of the sustained increases in housing prices over the last twenty years (average nominal yearly price rise of 5.2%) and the current uncertainty surrounding over/undervaluation of the housing markets. These credit risks are strongly concentrated on the banks’ balance sheets.

Note that the level of private debt (113% of GDP in 2015Q2) is considerably lower due to the exclusion of “intra-group” financing, received from other NFCs (domestic or foreign) or holding companies.
3. **The Belgian financial sector**

A. **The on-going transformation of the financial sector**

30. **Significant changes in the financial intermediation environment** – both in Belgium as well as at EU level – have taken place since the outbreak of the financial crisis. The pre-crisis years – when the expansion and international diversification of the financial sector (and in particular part of the banking sector) was accompanied by an increasingly sophisticated organisation, management and funding – gave way to a period of retrenchment characterised by return to core business and more recently to a rethinking of business models in the low interest rate environment. This retrenchment and deleveraging of banking activities has gone hand in hand with an increase in non-bank and especially shadow banking activities. Moreover, the geographical specialisation and concentration of non-bank financial activities in the EU has continued and gained momentum, with local finance centres with specific comparative advantages appearing, based in some cases on a favourable fiscal regime (Luxembourg).

31. **This retrenchment** – partly imposed by the EU under state aid agreements – was primarily observed in the banking sector which in the EU refocused significantly on core activities. Since 2012, the banking sector in the EU and especially in the EA has substantially deleveraged and structurally scaled back the size of its balance sheet. The outstanding amount of financial assets held by monetary financial institutions in the EA has thus contracted from a peak of approximately 36 trillion euro (362% of GDP) in the second quarter of 2012 to a trough of 31 trillion (313% of GDP) in the second quarter of 2014. The banking sector in the UK experienced a similar trend over the same period. The assets of British banks shrank from 16.5 trillion euro in the second quarter of 2012 (811% of GDP) to 12.7 trillion in the second quarter of 2014 (582% of GDP). **This deleveraging as well as the institutional reforms undertaken during the crisis** – i.e. banking union – and tougher regulatory requirements (see section 1) have made the banking sector overall structurally safer and more robust.

32. **Notwithstanding the deleveraging process in the banking sector, the size of the total financial sector in the euro area**\(^9\) (as measured by total assets) has increased since the crisis – albeit at a slower pace than during the pre-crisis years. Given the banks’ deleveraging efforts, this expansion is due to the expansion of the non-bank sector, including shadow banking. However, the increase in the balance sheet, from 28 trillion euro (283% of GDP) at the end of 2012 to 34 trillion (327% of GDP) in the second quarter of 2015, of the non-bank financial sector (i.e. investment funds, pension funds, insurance corporations and other financial institutions) partly reflects valuation effects.

33. While this parallel banking sector (shadow banking) offers scope for wider diversification of funding sources, an increased loss absorption capacity of the economy, and potential efficiency gains in capital allocation, it could also render financing flows more opaque and possibly increase risks through more extreme liquidity risks and leverage positions. **The shift towards a more important non-bank financial sector entails potential risks considering that the supervisory framework (and reach) in this segment remains more fragmented while the banking sector remains strongly intertwined with this shadow banking sector.** To the extent that the shift towards more non-bank intermediated finance

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\(^9\) Eurostat does not release financial balance sheet data for the EU taken as whole.
becomes structural – potentially supported by the EU’s Capital Markets Union initiative – there may be a need to extend the supervisory and macro-prudential reach and to ensure close coordination and information exchange between supervisors both at national as well as EU levels.

34. The Belgian financial sector shows similar tendencies with financial intermediation characterised by significant deleveraging in the banking sector and a relative shift towards more non-bank intermediated finance. But unlike the EA average, the total financial sector (when measured by total assets) has not expanded significantly and in % of GDP even declined in importance. At the end of June 2015, the total Belgian financial sector’s financial assets amounted to € 2,392 billion (591% of GDP), compared to € 2,390 billion at the end of 2007 (693% of GDP), mainly due to very strong deleveraging in the banking sector – as a consequence of the severe crisis and the dismantling of some financial institutions – but is also explained by the relatively lower growth in non-bank finance and in particular in the non-MMF and pension funds industries and the recent withdrawal of big multinationals from corporate finance centres. This also reflects the preference of Belgian banks for non-MMF funds in other member states (e.g. Luxembourg) with more favourable conditions. The latter observations may suggest an underperformance of the Belgian financial sector relative to its peers and could point to a competitive disadvantage.

35. The Belgian banking sector has undergone particularly heavy restructuring, mainly among the larger banks. This restructuring effort not only entailed a retrenchment to the home market – foreign assets now account for 53% of banks’ total assets, compared to 60% at the end of 2007 – and a re-focusing on core activities but also implied structural adjustments in other domains, including significant job losses. As a consequence of the post-crisis restructuring, decision centers of major banks relocated, even enhancing the international character of the sector. Moreover, following the different crises, one local large bank, Belfius, is currently fully owned by the State while Dexia, being in run-off, still carries substantial State guarantees.

36. Overall, these developments have led to a substantial reduction in the sector’s balance sheet, from 1,407 billion euro (408% of GDP) at the end of 2007 to 1,213 billion (300% of GDP) at the end of the second quarter of 2015. Against the background of difficult macro-financial conditions, Belgian banks are now operating in a saturated, mature domestic market with limited short- and medium-term growth potential, putting profitability of the sector under pressure. Cost-cutting measures, possibly implying some consolidation of the sector- are likely to be critical for the long-term viability of the sector.

37. However, the deleveraging at the aggregate level hides important heterogeneities. While the large banks have been cut down to size, smaller institutions have gained market share, especially in terms of deposits. While the largest banks held more than 82% of total bank assets before the crisis, this share dropped to around 57% recently. In the last few years, foreign branches have entered the Belgian retail market in view of abundant and cheap funding sources. And about 55% (in % of total assets) of the banking sector is currently owned by foreign institutions.

38. Important financial market infrastructures are located in Belgium, with a crucial role in terms of payment, securities clearing, and settlement and custody services. In view of all the new regulations, some of

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10 The impact of Dexia is estimated to be -360 billion over the period (-90% of GDP).
11 These figures are not affected by the resolution of Dexia.
these activities will become even more important despite fiercer competition from non-traditional players in some segments (e.g. payments).

39. **The Belgian non-bank financial sector (as measured by total assets) has continued to grow which, combined with the hefty deleveraging in the banking sector, has caused a shift towards more non-bank intermediation.** This growth (in particular of shadow banking) is explained by the expansion of securitisation activities, corporate finance centres (attracted by the favourable fiscal treatment, i.e. the notional interest deduction), the growth of investment funds, the growth of (mainly capital gains) in the insurance sector and pension funds. The growth in non-bank finance – from 983 billion euro (285% of GDP) at the end of 2007 to 1,179 billion (291% of GDP) at the end of the second quarter of 2015 – is nevertheless still largely connected to the banking sector, as banks are closely linked to the above-mentioned sub-sectors.

40. **Overall, seven years after the crisis, the Belgian financial sector has developed into a more diversified, more local and smaller (in percent of GDP) financial sector, including an important banking and insurance sector.** Compared to other European countries, the Belgian financial sector as a whole, measured in absolute size (assets under management) is still small. This observation holds not only for the sector as a whole but also for most of the sub-sectors, including investment funds, pension funds and (even) banking. The relatively small size of the Belgian financial sector and sub-sectors reflects not only a country-size effect where larger countries typically support a larger financial sector but also, and importantly, the lack of capacity/efforts/ecosystem to develop specific specialisations in one or more specific financial sub-sectors (such as Luxembourg in funds, the Netherlands in pension funds).
Financial assets outstanding at the end of the second quarter of 2015 and comparison to the situation 2007Q4
(Billions of euro)

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<tbody>
<tr>
<td>Monetary financial institutions</td>
<td>1,407</td>
<td>7,283</td>
<td>1,223</td>
<td>-2,469</td>
<td>1,213</td>
<td>9,062</td>
<td>1,114</td>
<td>-477</td>
</tr>
<tr>
<td>Insurance corporations</td>
<td>221</td>
<td>1,646</td>
<td>82</td>
<td>-</td>
<td>313</td>
<td>2,457</td>
<td>174</td>
<td>-</td>
</tr>
<tr>
<td>Non-MMF investment funds</td>
<td>117</td>
<td>1,075</td>
<td>1,981</td>
<td>-</td>
<td>140</td>
<td>1,164</td>
<td>3,698</td>
<td>-</td>
</tr>
<tr>
<td>Pension funds</td>
<td>14</td>
<td>-</td>
<td>0</td>
<td>-</td>
<td>24</td>
<td>2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other financial institutions</td>
<td>632</td>
<td>933</td>
<td>926</td>
<td>-</td>
<td>702</td>
<td>1,751</td>
<td>4,816</td>
<td>-</td>
</tr>
<tr>
<td>Total financial sector</td>
<td>2,390</td>
<td>10,937</td>
<td>5,036</td>
<td>-</td>
<td>2,392</td>
<td>13,610</td>
<td>9,804</td>
<td>-</td>
</tr>
<tr>
<td>Total financial sector (in % of GDP)</td>
<td>693%</td>
<td>590%</td>
<td>631%</td>
<td>19.257%</td>
<td>562%</td>
<td>13.697%</td>
<td>19.257%</td>
<td>1.461%</td>
</tr>
</tbody>
</table>

Note: the statistics are derived from the financial accounts data as published by Eurostat and refer to the balance of the resident financial sub-sectors. These statistics do not incorporate domestic investments in non-resident financial sectors.

Source: EC.

The recent evolution of the financial system reflects the first signs of disintermediation in Europe and the importance of specialised centres in different countries. While the funds and pension industry are particularly developed in Luxembourg and the Netherlands respectively, Belgium has developed a specialised financial industry with the financial market infrastructures.

B. The key challenges of the financial sector

41. In view of the retrenching on the domestic market, competitive pressures have increased and have been exacerbated by the entrance of small players, mostly in the form of branches in view of the abundant and cheap funding sources available in the Belgian economy. In view of the importance of digitisation, competition from non-traditional players could also become tougher, especially in the payments segment. While sound competition might be seen as positive if it leads to innovation and sustainable conditions for customers, it is important to ensure that competition does not lead to unsustainable financial conditions which would result in major and systemic financial instability. Recent experience also highlights additional risks arising from the financial soundness of new entrants (e.g. emerging countries) in view of important macro-financial imbalances. Obviously, it is a difficult balance to strike.

42. Although banks’ efficiency has increased somewhat in recent years, major challenges remain. The cost structure of the banks and insurance – in particular in view of the large number of branches (and offices) – remains high in Belgium compared to its peers and has not yet been adapted to the newly slimmed-down balance sheet, while banks and insurance undertakings are tending to fall behind in the recent digitisation wave.
43. **(Life) Insurance companies are particularly vulnerable to the low interest rate environment** given the many existing contracts with a high guaranteed rate. The recent modification of tax treatment for individual life insurance products has made a huge dent in demand, which raises fundamental questions about the development of this type of product and a change in insurance companies’ business models. The entry into force of Solvency II constitutes another big challenge.

44. **Pension funds in Belgium face similar risks to life insurance undertakings, albeit to a lesser extent in view of their asset structures.** Pension funds have remained relatively limited in view of the structural features of the Belgian economy characterised by SMEs for which setting up Organisations for Financing Pensions (OFPs) might be relatively complex and expensive. In this context, OFPs have been set up for the different sectors in recent years allowing smaller firms to join. The recent legal framework introduced in Belgium has attracted pan-European OFPs (of multinationals). However, further development of this sector in Belgium is hampered by various social and fiscal regulations. For instance, under the current legal (social) framework, social security contributions for invalidity and solidarity need to be paid by pan-European OFPs even if the pension benefits are paid to foreign pensioners who never receive benefits from the Belgian social security system.

45. **While financial market infrastructures were quite resilient during the financial crisis, the current economic and financial conditions and the regulatory reforms have put pressure on them to adjust their business model** – by developing new activities – and their pricing structure because they will no longer be able to rely on the interest generated by deposits, and will have to turn to a more direct form of revenue, namely fees and commission. Given the nature of their business activities, financial market infrastructures are particularly vulnerable to IT and cyber risks. This warrants close monitoring.

46. While financial institutions’ profitability as well as their liquidity and solvency position have improved in recent years, albeit in a heterogeneous manner, they still face important challenges in keeping up a sustainable level of profitability and a sound business model:

i. In view of the retrenching on the mature domestic market and the low growth environment, financial institutions’ profitability will remain under pressure in the absence of further active measures.

ii. The persistence of low interest rates could affect the fundamentals of banks’ intermediation and create major risks for life insurers which still have liabilities with high guaranteed rates.

iii. Developments of fee and commission business to mitigate the low interest rate environment will also lead to fierce competition among Belgian players – diminishing margins in the medium term. Strong developments of assets under management could also lead to additional risks for financial stability (due to the illiquidity of the funds, among other things).

iv. Digitisation of financial institutions constitute a major opportunity but also a key challenge which could result in the short term in substantial investment (to modernize their IT systems) and further pressure on profitability while the current distribution channels or even the whole business organisation have not yet adapted to the new environment (e.g. size of network). Technology is evolving quite fast which might call into question banks’ current strategy of

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12 Setting up OFPs is quite expensive for small SMEs. Insurance group contracts are easier in this context.
investing individually in these new technologies instead of looking for a much-needed business model embracing the digitisation trend allowing them to keep close relationships with their clients and added-value services.

v. New IT and other technological developments raise major challenges in terms of IT and cyber security

vi. The existence of pockets of vulnerability in the banks' mortgage portfolio characterised by high LTVs (> 80%) and DSTI (>30%) could weigh on future profitability and raises the question of sustainability of household debt.

47. Another focal point concerns the development of derivative products, although Belgian banks generally tend to be somewhat less exposed than other major European players. However, failures in these markets could spread rapidly to whole financial industry in view of the interconnectedness of derivatives exposures and the huge – and still growing – amounts concerned. Counterparty risks on these instruments should not be neglected. Recent regulatory initiatives have been introduced – such as mandatory reporting to trade repositories and the clearing through central counterparties of all standardised contracts through central counterparties and traded on exchanges or electronic trading platforms. While these reforms tend to reduce risks, they might have side effects that could lead to important disruptions in the future (e.g. higher concentration risks for central clearing parties). This needs to be closely monitored at international level.

All these elements – and in particular, excess liquidity and low profitability – translate into a challenging environment for the authorities to avoid new developments as observed in the past (search for yield). In view of the structural reforms implemented in Belgium, search for yield in the form of trading activities – especially proprietary trading – will be not be feasible for banks but other types of risk could emerge.

i. The development of shadow banking activities (e.g. fund industry) reflects this phenomenon. While these activities could contribute to the diversification of the financial sector, they also lead to complexity and opacity in the financial system. It can also create risks if it takes excessively mismatched positions in terms of interest rate and liquidity risks. Excessive use of leverage can also contribute to higher risks. Moreover, shocks within the shadow banking sector may spill over to the rest of the financial system, due to interconnections with the traditional banking sector. Asset managers also use similar models and scenarios which might lead to important volatilities in case of herd behaviour. The challenge for prudential authorities is to maximise the benefits created by the shadow banking sector while minimising systemic risks. This would require close monitoring both at national and international level.

ii. In addition, financial services companies might have incentive to develop new activities in new markets. The challenge will be to ensure that risks are correctly priced and their risk profile is accompanied by sound capital, liquidity, risk management and governance requirements

48. All in all, financial institutions’ business models need to be further adapted to the new operating conditions in order to lay the foundations for sound solvency positions and sustainable profitability throughout the economic and the financial cycles.
4. Financing the economy and surplus savings

49. Despite the major restructuring and deleveraging efforts in the financial sector (and in banking in particular) during the financial crisis, no substantial credit crunch has been observed in Belgium. With Belgian banks’ retrenchment on home markets and reorientation on their core business (the prime funding source in an SME-dominated economy), the financial sector has continued lending to the Belgian economy. Apart from short periods in 2009 and 2014, (bank) lending to the Belgian economy continued to grow, especially for SMEs. Bank lending to large companies has declined but mainly as a consequence of substitution of bank lending by bond financing. After an initial period of tightening, credit supply conditions have improved considerably since the beginning of 2014, certainly when compared to some other euro area countries. As a consequence, access to finance was not the biggest constraint faced by SMEs: rejection rates and bank lending rates have remained relatively low compared to peer countries. Moreover, since the (anticipation of the) ECB’s Asset Purchase Programme (APP), market rates and retail lending rates to SMEs have come down substantially. Bank lending rates (including those for long-term small loans) are now substantially below pre-crisis levels. However, the pass-through of falling market rates was incomplete as banks had boosted their commercial interest rate margins considerably since the beginning of the crisis. Despite the relatively favourable supply conditions; overall investment and credit growth remains low in Belgium mainly reflecting subdued credit and investment demand.

50. Even though the financial sector continues to support the funding of the Belgian economy, a shift in risk tolerance has to some extent reduced the economy’s risk-taking capacity. The financing of an SME-dominated economy such as Belgium remains to a large extent driven by financial intermediation and in particular banks and not by direct financing through capital markets. But banks’ credit supply policy increasingly focuses on firms and projects with an average risk profile (lower risk weights), while (bank) exposures to higher risks – either in the form of more risky SMEs or long-term and/or project finance – are being scaled down. Given the limited access to alternative financing sources, SMEs with higher risk profiles find it more difficult to obtain the required levels of external financing. According to the ECB’s Survey on the Access to Finance of Enterprises (SAFE), about one-third of the SMEs still consider access to (external) finance a significant problem. A myriad of initiatives to improve the funding of financially-constrained SMEs have been introduced by respective governments, both at the regional and federal level. Improved coordination and communication as well as some rationalisation of these initiatives could still reduce information and search costs for SMEs and potentially lead to more efficient allocation of these funds.

51. Owing to high fixed costs related to overcoming information asymmetries, direct access to capital market finance (through issuance of bonds or equity) is still mainly restricted to larger companies. Even though direct finance through capital markets has been increasing recently (in particular through bond issuance), it is still restricted to the larger companies. Efforts to open up capital markets to SMEs (e.g. Alternext, Enternext, securitisation…) have so far not been very successful in Belgium. Among the main (prohibitive) impediments to SMEs’ access to capital markets that are often mentioned are information disclosure rules, tough prospectus requirements and the potential loss of control over the company. Alternatives such as crowdfunding, although exponentially growing in importance, currently lack the (legal) framework and the critical size to become a stable and robust
alternative source of finance at this stage. The development of these alternative forms of funding needs
to be carefully monitored as these markets might initially attract lower-quality borrowers.

52. On the basis of statistics collected by Invest Europe (data up to 2014), total private equity and venture
capital investment in the Belgian economy remain relatively low. Total private equity investment as
a percentage of GDP is below the European average while Belgium does somewhat better for venture
capital investment. But Belgium does not rank among the strong performers in either category. A decline
in invested ‘growth capital’ has even been observed. Although these statistics are unable to identify the
source/cause of the decrease (either demand or supply), they could be indicative of the absence of a
very dynamic private equity market in Belgium. There are some first indications that the private equity
market may have revived in 2015, especially for smaller-scale investments.

53. Belgian households and to a lesser extent non-financial corporations continue to have strong
liquidity preferences in their investment profiles, creating surplus liquidity/savings at the level of
the Belgian economy. This liquidity preference in investment is reflected in the strong demand of these
sectors for highly liquid and safe investment products, in particular savings deposits (net transactions by
households in the latter amounted to €67.4 billion over the period 2010Q1-2015Q2, compared to
€18.1 billion in investment funds and €155.3 billion for all financial asset categories), and partially
reflects the build-up of precautionary savings buffers during the crisis as well as the low interest rate
sensitivity of household investment. As a consequence, the liquidity preference persists (albeit somewhat less strongly) in the current low interest rate environment and is exacerbated by high savings
in the context of relatively low statutory pensions.

54. Moreover, the current favourable fiscal treatment of this type of savings instrument further
encourages investment biases towards regulated saving accounts, at the expense of more long-
term and/or more risky investment. Against the background of persistently low interest rates and an
ageing population, a possibly more efficient investment allocation (e.g. more dedicated long-term
investment) could be considered. An analysis of the optimality of the current fiscal treatment of
investment income could be relevant given that the current fiscal rules generate a strong (‘focal point’) advantage for regulated savings accounts.

55. As a consequence of the strong liquidity preference of Belgian investors, surplus
liquidity/savings have built up in the Belgian banking sector. The net financing of the resident
banking sector by Belgian households (i.e. surplus savings) amounted to 46% of GDP in 2015Q2. This
pool of surplus savings both entails advantages and disadvantages. On the one hand, this large pool of
savings generates a stable (and relatively cheap) source of funding for the banking sector. On the other
hand, these savings are not necessarily put to the benefit of the Belgian economy. A significant part of
the savings surplus is sourced abroad by foreign banking groups, mostly in the context of intra-group
operations. The total of net intra-group interbank claims of resident banks was estimated at about €90
billion, a large part of which was sourced by branches or subsidiaries of foreign banks. Although these
cross-border flows may be unavoidable (and possibly induce more efficient capital allocation) in the
integrated EU financial market, the question arises whether they should be implicitly subsidised
through the current favourable (discriminatory) tax treatment of savings deposits.
Part 2: Recommendations

Introduction

For more than half a year, the High Level Expert Group (HLEG) has been analysing the financial sector. The Group has collected a lot of factual information about the Belgian financial sector and received many suggestions from financial experts, stakeholders and social partners outside the financial sector for improving the state of finance in Belgium. In the previous chapter, we have described the current situation of the financial sector in Belgium, and analysed the problems and challenges that it faces today and is likely to face tomorrow. Based on these considerations, the HLEG has formulated ten recommendations that are detailed in the next chapter, which, if implemented, we feel would help to improve both the resilience and competitive position of the financial sector.

The thrust of our recommendations rests on the premise that the objective of the Belgian public authorities towards the Belgian financial sector is to ensure that it operates at the service of the Belgian economy and society by helping to deliver stable and sustainable growth.

To achieve stability and growth, the financial system has to be resilient and the financial sector must be competitive and efficient. Financial resilience is more important than just financial stability and implies that the financial system should be robust and be able to absorb shocks.

Financial sector competitiveness entails improving the status of Belgium, and in particular Brussels, as a financial centre. The World Economic Forum ranked Brussels 62nd in the list of global financial centres in 2015. This report does not want to give the impression that there is a silver bullet that can propel Brussels into the top 10, or even the top 20 of world finance. It is unlikely that Brussels could match the current status of even Luxembourg (ranked number 19) any time soon. However, many comparable cities currently rank much higher than Brussels. This is for instance the case of Vienna, Stockholm or Amsterdam that rank respectively 30th, 32nd and 36th on the WEF 2015 list. The HLEG believes that Belgium is punching below its financial weight and that the country can significantly improve its position.

Medium-sized cities in relatively small countries can become important global financial centres if they possess at least two of the following three factors:

- A stable, predictable and business-friendly legal, prudential and tax framework;
- An ecosystem of knowledge, expertise and corporate excellence resulting in international friendly environment;
- An environment offering tax arbitrage and/or regulatory arbitrage possibilities.

We do not believe that sustainable competitiveness should rely on tax or regulatory arbitrage. Therefore, the HLEG has concentrated its efforts on how to improve the competitiveness of the Belgian financial sector relying on the first two factors.

The HLEG strongly believes that the Belgian public authorities should provide more stability to the legal, prudential and tax framework, which would make Belgium and Brussels more attractive and more competitive for financial activities. We also believe that the Belgian public authorities can take certain steps to improve the financial ecosystem in Belgium and in Brussels in particular. This being said, the HLEG insists that a sine qua non
condition for the long-term competitiveness of a financial system is its resilience. So, provided the system is resilient, there should be no trade-off between measures to promote competitiveness and financial stability.

The HLEG did not embark on a journey to formulate a wish list of tax measures and incentives that could shortcut the necessary long-term structural policy measures. This would make our report vulnerable to lobby pressure, but most importantly, would be unrealistic in current budgetary circumstances. The common denominator in all the hearings we had with members of the financial community is the primacy of tax stability over tax incentives.

The Minister of Finance explicitly asked us to highlight sectors with high potential for the future. We see the highest potential in a better use of Belgium’s “financial raw material”: high savings. Furthermore, Brussels already has a sector with high potential, namely the important financial market infrastructures, including the payments industry. Special attention should be given to strengthening the position of these activities in Belgium and to use their presence to create a wider fintech industry and expertise centres: software, services and knowledge that spreads to other financial or economic activities in Belgium and can be exported to other financial centres throughout the world.

The Belgian economy is characterised by the abundance of financial wealth. An important part is channelled through saving deposits, which might handicap long-term funding. With the ageing population, public authorities should ensure taxation does not distort and discourage the supply of appropriate savings products and investments vehicles. Apart from the high savings ratio, Belgium is characterised by the presence of local SMEs and a lot of international multinationals. Public authorities should strive to maintain a level playing field between both large and small companies in any new measure they envisage towards the financial sector.

Financial regulation and supervision have been strengthened since the financial crisis. This new regulatory set-up implies that the financial industry will still need to adapt its business model and culture. In addition, the environment of the financial sector will remain very challenging in the coming years due to low growth, low interest rates, low risk premiums, high competition, and the accelerating digital revolution. In this context, a financial crisis is always looming, and measures should be taken to prevent, anticipate and make the sector more robust. This is key to defending Belgian taxpayers in the future from a massive bailout akin to that seen after the 2008 crisis.

This report, therefore, makes recommendations to strengthen not only the competitiveness of the financial sector in Belgium but also its resilience. Accordingly, the 10 recommendations put forward by the HLEG should not be read as a menu from which to pick and choose, but as a consistent and coherent package of necessary measures to achieve resilience and competitiveness of the sector.

To ensure financial resilience, Belgian authorities should treat carefully any potential sources of financial instability like debt, leverage, asset overvaluation and a combination of these elements. They should also be mindful of not encouraging such elements by tax measures. In this spirit, the HLEG makes a number of recommendations about real estate, the economy’s largest asset class, and about the tax system.

The HLEG also wants to stress the importance of cyber security and IT risks, which are becoming more frequent and important, both for financial stability and for Belgium’s competitiveness, especially in data-intensive activities such as financial services. This is a shared challenge, even a responsibility, between the financial sector and the federal government, in particular national defence. The Minister of Defence has flagged up the same concern, and therefore both he and the Minister of Finance have to take this issue seriously and set up a task force with the financial sector, and more importantly, invest in systems and people to tackle the risk.
Finally, the global financial sector has evolved since the crisis of the 2000s. It has changed, mostly for the better. But the next crisis is always different than previous ones; shadow banking is growing, the level of derivatives is still quite high, and there are still financial products that are excessively complex. Low interest rates, seen as one of the cures for the previous crisis, might become more of a root cause of the next one, especially for insurance companies, if they persist over a longer period. The risk culture has changed but there is still a need to restore public trust in the financial services industry and to take measures that foster financial integrity and reduce the risk of excessive risk-taking behaviour.

Finally, the interconnectedness of the financial industry, for instance via the CCP’s, and concentration of financial markets are still increasing and could lead to even stronger contagion in the next crisis. This should be addressed in meetings of the Belgian financial authorities with their European counterparts.

The remainder of Part 2 details our ten recommendations for a better financial sector at the service of the community in Belgium. Our goal is to improve both financial resilience and the competitiveness of the financial sector rather than favour one or the other.

In addition to these recommendations, the HLEG calls for the establishment of a permanent discussion platform for the financial sector involving all the relevant stakeholders. Its goal should be to exchange views about the business and regulatory environment and the financial ecosystem in Belgium. One of its first tasks should be to discuss the recommendations of this report.

Finally, the HLEG calls for the consistent and coherent promotion of the Belgian financial industry in international missions.

The HLEG has carefully considered many options and has benefited greatly from the valuable input from all stakeholders. We worked constructively in total independence and with wide consensus.
Recommendation 1: Enhancing the current regulatory and supervisory framework

1. **The issue**

In the aftermath of the financial crisis, important supervisory and regulatory reforms have been introduced at the global, European and Belgian levels to enhance the resilience of the financial system and avoid a repeat of the recent economic and financial crisis. The post-crisis reform agenda is however not yet fully implemented and has been uneven across sectors. In addition, new risks are emerging in the current low interest rate and economic growth environment, which might call for further regulatory reforms with due consideration for long-term economic growth.

The revision of the supervisory framework at European level with the introduction of the banking union marks an important turning point for the euro area – and also for the Belgian banking market. However, an essential pillar of the banking union is still missing, namely a European Deposit Guarantee Scheme. In late November 2015, the European Commission announced plans to have a full European Deposit Insurance Scheme (EDIS) by the year 2024. The HLEG is in favour of adding this missing link to the banking union. An issue which has not yet been addressed is the amount for the European deposit guarantee and in particular whether it remains at the current level applied in the EU. Many considerations will have to be taken into account, including the need to limit the risk of moral hazard by further strengthening financial system’s resilience.

2. **General principles**

The HLEG recommends that the Belgian authorities further enhance the regulatory and supervisory framework taking into account the following principles:

1. Responsibilities for supervision and resolution should be aligned at the same level with political and financial responsibilities.

2. All segments, products or activities of the financial sector which have a systemic dimension should be supervised and fall under a coherent and appropriate regulatory framework.

3. New reforms or revision of existing reforms should take into account (1) their potential impact on the real economy, (2) the risks of regulatory arbitrage and (3) the complexity of the regulatory framework.

4. The regulatory and supervisory framework should be enhanced by integrating the cross-sectorial dimension of the financial sector (interconnectedness, regulatory arbitrage) at international level.

5. New regulatory initiatives at the Belgian level should take into account developments at European level (see Recommendation 7).
3. **Specific recommendations**

Given the pending challenges and the general principles outlined above, the HLEG recommends the following measures to improve the regulatory and supervisory framework:

### 3.1 Supervisory framework

1. The Belgian authorities should maintain the current supervisory framework in Belgium, which is in line with recent developments at European level. The HLEG underlines the importance of active collaboration among all the authorities concerned.

2. The Belgian authorities should support a wider role for the FSB (with the IMF) in the development of a cross-sectorial regulatory and supervisory framework for systemic institutions. In addition, they should back the project to complement national FSAPs with a worldwide FSAP, in addition to the Global Financial Stability Review (GFSR), which would focus on global systemic risk and interconnectedness (CCPs, derivatives, contagion, shadow banking, etc.).

3. To make the banking union effective, the Belgian authorities should strongly support the introduction of the 3rd pillar of the banking union, the European Deposit Guarantee Scheme, in line with the June 2015 Five Presidents’ report on Completing Europe’s Economic and Monetary Union and the recent proposal made by the European Commission. To be effective and credible, the European DGS – which would be financed by the banks themselves – should have a liquidity line with the ESM. The HLEG notes that this would have an impact on Belgian public finances, since under the current public accounting system, contributions by financial institutions to the national DGS are treated as federal State revenue. As recommended in the FSAP, these contributions should be held in a separate fund independent from the State accounts.

### 3.2 Regulatory framework

1. The Belgian authorities could support at the European and international levels a global assessment of the new financial regulatory framework put in place in response to the financial crisis. Assessing the cumulative impact of recent reforms could include an in-depth analysis of (i) the benefits for financial stability and the real economy, (ii) any unintended consequences, (iii) the potential need for further reforms to close existing loopholes, and (iv) coherence and consistency of the reforms across sub-sectors.

2. In view of the remaining vulnerabilities in the (Belgian) financial sector, the HLEG recommends the following measures:

   i. **Banks**

   - The Belgian authorities should support the finalisation of post-crisis agenda and especially, the implementation of the leverage ratio, the NSFR, the MREL and the current revision of internal models, with due consideration for long-term sustainable economic growth.
The Belgian authorities should support measures which would simplify the current financial regulatory framework, such as banks’ internal models for certain risks, provided they do not lead to any risks for financial stability.

ii Sovereign exposures

In the context of current discussions at European and international levels to review the prudential treatment of sovereign exposure of banks, Belgian authorities are invited to support the efforts to increase financial institutions’ resilience to sovereign risks with due consideration for the impact of the change in regulatory framework on the real economy. This would significantly reduce the financial risk of the banking sector and in particular of sovereign-bank ‘doom loops’ that featured in some countries of the euro area during 2011-2013. It would also help reduce the potential moral hazard from the European Deposit Insurance Scheme (EDIS) and therefore it would help convince some European countries of the desirability to introduce a European deposit guarantee scheme as part of the banking union.

iii Insurance companies

- The HLEG welcomes the agreement among social partners to review the minimum guarantee rates for group life insurance contracts to better align conditions with market developments. In this context, the Belgian government should review the maximum guarantee rates for (individual and group) insurance contracts taking into due consideration moral hazard, competition and financial stability concerns. The HLEG calls for a swift implementation of the review.

- In the absence of initiatives at European level, the Belgian authorities should examine the possibility of having a new legal framework for the recovery and resolution of systemic insurance companies and pension funds. In line with the banking resolution framework (BRRD), the main objectives of the insurance recovery framework should be: 1) to safeguard the continuity of essential insurance operations, 2) to protect clients, 3) to minimise risks to financial stability and reduce the cost for tax payers, and 4) to avoid the unnecessary destruction of value.

- In the absence of any specific resolution framework, additional instruments could be foreseen to deal with important systemic risks caused by the failure of an individual systemic institution (or by a systemic shock), taking into consideration moral hazard.

- The competent Belgian authorities should develop a coherent macro-prudential framework for insurance companies, including identification of systemic institutions and an assessment of macro-prudential instruments, in line with forthcoming developments at European level.
iv Financial market infrastructures and innovation

- As new entrants become more active in parts of traditional value chains, authorities should remain vigilant to ensure that activities remain subject to sufficient regulation and supervision.

- To facilitate a less cash intensive environment and ensure adequate security, the competent authority should enhance the regulatory and supervisory framework of payment infrastructures to ensure stability and continuity of payment transactions and the payment system.

- The macroprudential authority should develop expertise in financial market infrastructures’ interactions with other actors of the financial system in order to better understand contagion risks.

v Shadow banking and derivatives

- The competent Belgian authorities should closely monitor the risks related to shadow banking and the interconnectedness with other (financial) sectors. Taking into account their respective responsibilities, they should report back to the Minister of Finance on these risks, especially those related to systemic risks relative to the development of the asset management industry, and on potential considerations with respect to consumer protection by mid-2017.

- The supervisory authorities should report to the government on developments in derivative products in the Belgian financial system and the systemic risks involved by the end of 2017.

vi Consumer protection

- The competent Belgian authorities should ensure that consumers have better and more transparent information on which to base their investment decisions. The present regulatory environment involves a lot of paperwork and there is too much and excessively complex information.

- Debt sustainability concerns in some segments of the households sector require specific attention from all competent Belgian authorities (see recommendations 2 and 3). Deteriorating economic growth prospects could potentially lead to the materialisation of debt sustainability concerns, with negative implications for the financial system.
Recommendation 2: Enhancing the resilience of the real estate market

1. **The issue**

One of the lessons of the financial crisis is that micro-prudential supervision was wrongly assumed to be sufficient to preserve the stability of the financial system as a whole. This prompted the adoption of macro-prudential policy in many jurisdictions, all EU countries included.

International financial crises are often caused by (commercial and/or residential) real estate bubbles, which are typically combined with increasing and high leverage of households and lax credit standards at origination. Moreover, financial crises caused by real estate bubbles tend to be particularly harmful to society due to the large output losses they tend to generate.

In designing instruments for macro-prudential policy, policy-makers have therefore typically focused their attention on instruments to contain bubbles in real estate markets. Three types of instruments have been suggested: (i) caps on loan-to-value (LTV) ratios and/or debt-to-income (DTI) or debt-service-to-income (DSTI) ratios, (ii) additional risk weights in the context of capital requirements and (iii) dynamic provisioning.

In Belgium, the residential real estate market has been quite buoyant in the past 20 years. Household debt has also increased, reaching currently almost 60% of GDP. That is close to, but still below the euro area average. Various analyses have shown that, although Belgian credit institutions have applied fairly prudent credit standards to mortgage loans compared to other countries, some sub-segments of their outstanding mortgage portfolios are exposed to relatively high risk levels reflected by high LTV or DSTI ratios. This could lead to important losses for Belgian credit institutions in the event of a sharp downturn in the Belgian real estate market.

As a result, the NBB – as Belgian macro-prudential authority – has decided to impose some macro-prudential actions at the end in 2013 (an increase of 5 p.p. in IRB banks’ risk weight for their Belgian mortgage exposures). While this measure is an important step in strengthening the resilience of Belgian banks, it did not reduce in any significant manner households’ vulnerabilities, as it was not targeted at the riskier segments.

2. **General principles**

In view of the current situation in the real estate market, Belgian authorities should consider adopting macro-prudential measures over and above those already taken.

Given the importance of mortgage loans in Belgium and the potential impact of various macro-prudential measures, the following general principles should guide specific recommendations:

1. Authorities should have at their disposal appropriate instruments to mitigate real estate bubbles.

2. Measures aimed at enhancing households’ and banks’ resilience are important to mitigate systemic risks to real estate markets.

3. In setting macro-prudential measures, the authorities should pay attention to the potential impact on macro-economic activity.
4. There needs to be coherence in the actions taken by authorities at different levels (federal and regional) in order to ensure the effectiveness of measures aimed at mitigating risks to real estate markets.

3. Specific recommendations

Macro-prudential policy for residential housing mortgages can have two broad objectives: maintaining or increasing the resilience of households and the financial system in general; and/or mitigating the risk of a real estate bubble. The first objective is the less ambitious and easiest to implement. It requires setting constant maximum LTV and/or DTI/DSTI ratios. To achieve the second objective, the value of these ratios should be set counter-cyclically and thus vary over time.

Setting a counter-cyclical maximum LTV (and/or DTI/DSTI) ratio is likely to be challenging. It assumes that the authorities can read the real estate cycle correctly. There is not much evidence that countries can prevent real estate bubbles or affect them significantly by varying LTVs (and/or DTIs/DSTIs) over time. There is more evidence that such a policy can limit the downswing after the bubble bursts. Moderate or low LTVs (and/or DTIs/DSTIs) effectively increase buffers in the economy and that may limit the damage after the bubble bursts. There is not yet much experience with using maximum LTV (and/or DTI/DSTI) ratios, certainly not in advanced Western economies.

Given the high political sensitivity of interfering in real estate markets, the practice in many countries is for the government to decide on the basis of a recommendation from the macro-prudential authority. This is also the case in Belgium. The macro-prudential authority (the NBB) may make a recommendation with respect to the LTV (and/or DTI/DSTI), but ultimately it is the federal government that has to decide whether or not to implement it.

The cap on LTV applied by a number of countries typically ranges between 70 and 100%. In Belgium, currently roughly 40% of outstanding mortgages have an LTV above 80% at inception, partly due to the current tax regime.

Based on these considerations, the HLEG recommends:

1. The relevant authority to introduce a cap on LTVs constant over the cycle with the following modalities.

i. In view of the potential impact on the economy, to introduce the cap on LTVs gradually, starting from a relatively high level (e.g. 100%) and gradually reducing it in steps to a lower threshold (e.g. 85%)\(^{13}\), to assess the option of introducing a proportionate cap allowing certain segments of the population to still have access to the mortgage market (e.g. 10 to 20% of new mortgage credit production would still be above the cap). It should be clear that the measure is related to the moment that the mortgage is contracted. A cap on LTV would also contribute to mitigate excessive household indebtedness.

ii. The final decision by the federal government about the specific modalities for introducing the recommended maximum LTV limit should be based on a comprehensive assessment including one by the NBB, acting as macro-prudential authority. The assessment should cover the

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\(^{13}\) Given the current transaction costs on housing purchases (between 15 and 21% of the property value depending on the type of property), setting a LTV cap at 85% would imply that households would need equity equal to between 30% and 36% of the property value, i.e. 15% plus the transaction costs.
appropriateness of the measure in enhancing the resilience of borrowers and of the financial sector itself and its impact on the real economy. It should also take into account other regulatory (such as capital risk weights) and tax measures related to the Belgian housing market. Introducing a maximum LTV may be combined with changes in these other regimes. It should also take into account potential unintended consequences, such as the impact on the rental housing market and shifting of mortgage provision to institutions outside the scope of the maximum LTV regulation or to other types of loans (e.g. personal consumer loans). The assessment by the NBB could be complemented by an FSMA opinion regarding consumer protection.

iii. To ensure the effectiveness of the measure, the authorities should harmonise the definition of LTV across financial institutions. In the absence of any EU harmonisation, this could be done through Belgian legislation.

iv. To assess every 3 to 5 years the impact of the measure on (1) the real estate market, (2) the resilience of borrowers and the financial system, (3) the real economy, and (4) unintended consequences. Such an assessment could also include recommendations to enhance the appropriateness of the measure.

v. To consider the possibility of giving the macro-prudential authority the right to change the maximum LTV limit by 5 percentage points at its own discretion.

vi. Not to complement initially the maximum LTV by a maximum DTI or DSTI. The usefulness to do so could be considered in a few years based on the assessment of the LTV cap.

vii. To currently restrict the introduction of the LTV cap to the residential real estate market as there is currently insufficient information available to assess the potential impact of LTVs on the commercial real estate market in Belgium. The HLEG recommends that the Belgian supervisory authorities (i) collect more information about the commercial real estate market, (ii) ask credit institutions to improve loan policies and data quality and (iii) conduct an analysis of the market and its vulnerabilities.

2. To enhance coordination between federal and regional authorities in taking measures affecting the real estate market. This coordination should be based on an opinion from the national macro-prudential authority.

3. Finally, as part of the forthcoming revision of the CRR/CRDIV, the Belgian authorities should support the need to introduce more flexible instruments and procedures targeted towards real estate bubbles (e.g. revision of Article 458 of the CRR).
Recommendation 3: Changing the tax treatment of financial assets

1. **The issue**

Tax systems and tax incentives influence to a large extent the structures, the activities of the financial sector and actors’ behaviour.

In Belgium, the tax treatment of financial assets (and the income they generate) varies a great deal across assets. Some are tax-exempt (savings deposits up to a certain amount and capital gains), some benefit from a preferential tax treatment (real estate) and others are subject to a 25% (27% from 2016 onwards) withholding tax (all interest income except from savings accounts). Some are even subject to a specific tax (life insurance branches 21 and 23).

In addition, the tax treatment varies substantially across sectors (e.g. between insurance and banks). Finally, as in other countries, although to a lesser extent, there is a large distortion in the tax treatment of debt and equity financing instruments in favour of debt.

These distortions in tax treatment tend to encourage leverage and thus create potential financial imbalances.

2. **General principles**

The following principles should guide specific recommendations for the tax treatment of assets with a view to making the Belgian financial system more resilient:

1. The tax treatment of financial assets and/or of the revenues obtained from those assets should be as neutral as possible so as to avoid biases in the allocation of resources and mitigate distortions to the real economy.

2. This neutrality should apply across the different segments of the financial system, across different types of financial instruments and types of activities.

3. The tax treatment review should not promote any further increase in leverage or indebtedness of the non-financial sector.

4. Changes to the current tax regime should also promote efficiency and fairness by minimising distortion in the economy arising from specific tax treatment, by reducing the risk of tax loopholes or evasion, by reducing its complexity and by minimising the cost of complying with the tax regime.

3. **Specific recommendations**

The HLEG considers that weaknesses in the current tax system in Belgium would merit a fundamental revision of the tax system in order to support sustainable economic growth. But this would clearly fall outside the scope of its mandate and its expertise.

Our specific recommendations concentrate on four areas that are directly related to our mandate and expertise:
### 3.1 Taxation of savings

The HLEG is of the opinion that current tax incentives disproportionately favour (regulated) savings accounts and create important distortions. First of all, it might handicap long-term investment. Second, the system is moreover very complex in calculating the yield on these deposits. Third, the current legislation is not being correctly enforced. Indeed, there is no watertight control on the number of savings accounts that benefit from the measure as people have savings accounts in different banks in order to (illegally) maximise the benefit of the measure.

All these elements have a structural impact on the Belgian financial industry: a large number of banks have built up heavy dependence on savings accounts for their funding. While this might be seen as an important advantage to reduce reliance on short-term wholesale funding, it may also increase somewhat interest rate risks. But more importantly, it results in low funding costs for banks and excess deposits, which are partly channelled abroad through foreign subsidiaries and branches. This favourable tax treatment of banking funding creates distortions with other types of financial assets (such as equity) and long-term investments, leading to excessive reliance on banks for financing the Belgian real economy.

Finally, given the protection foreseen by the deposit guarantee scheme for up to 100,000 €, the current system exposes Belgium to all the downside risks in times of financial difficulties as the country is liable for all regulated savings accounts, but it does not benefit fully from the upside as an important part of these funds are used to fund projects outside Belgium.

Based on all these elements, the HLEG recommends:

1. **To not further subsidise such kind of instrument and not create distortions with respect to other financial assets.** In view of the high savings rate and the presence of substantially stable alternative instruments, a specific tax advantage for savings accounts does not seem warranted and the system could therefore be abolished. The abolition of this system could strengthen financial stability, not least by inducing a more diversified (and possibly more market-based) financing of the real economy, especially long-term investment.

2. **However, in view of the importance of the instrument in the banks’ own financing,** abolition of these tax advantages should be gradually phased in, preferably over a number of years in order to ensure financial stability.

### 3.2 Tax incentives for mortgages and other debt

The HLEG is of the opinion that tax deductibility of mortgage debt can lead to excessive leverage and fuel real estate bubbles. It also tends to increase the real estate prices rather than its affordability.

This favourable tax treatment contrasts with the relatively high transaction costs, including taxes, on real estate which hinder mobility and reduce affordable housing.

Based on all these elements, the HLEG:

1. **Welcomes the first decisions taken by the Regions to reduce this distortion and urges them,** where the tax advantage still exists, to reflect on the relevance of this tax treatment and on whether this advantage ought to be further phased out.
2. Proposes a reduction in transaction costs, including taxes, on property purchase, which could be financed by lowering tax allowances on mortgages. This would require a transition period in view of the potential negative impact on regional budgets.

3.3 **Tax measures to attract financial activities**

Up to the beginning of this century, Belgium had a system of tax incentives to attract headquarters and treasury centres, the so-called coordination centres. This system was abolished following complaints from the European Commission that it broke EU state aid rules and resulted in distortions of the Single European Market. The system was replaced in 2006 by a system of “notional interest deduction” (NID), whereby companies subject to corporation tax could deduct a notional interest amount on their own funds. Compared to the old system of coordination centres, this new system has a broader impact on the whole corporate sector and thus a more significant budgetary cost. Therefore (and also in line with falling interest rates) this deduction has been significantly reduced in recent years.

The HLEG is of the opinion that:

1. The option envisaged by the government to scale back the system for the financial industry seems a reasonable approach as the financial services industry is subject to specific capital requirements and thus does not need an additional tax incentive for that purpose.

2. Specific and targeted taxes – which would support the development of specific and/or niche business, such as pension funds, private equity, payments systems and non-banking financial activities – may have a distortionary effect on resource allocation, and should therefore – in the absence of any clear market failure – be avoided as far as possible.

3. The development of such niche activities hinges more on factors such as prudential rules and regulation, the capacity to attract highly-skilled labour, the availability of transparent rulings, the presence of a pro-active and flexible business environment than on specific tax advantages (see recommendations 6 and 8). In this context, the HLEG feels it would be more efficient and effective to support these factors than develop specific and target taxes.

4. Recent inefficiencies and unintended consequences of existing double taxation (e.g. in the case of international pension funds) would merit expanding double taxation treaties to avoid assets being taxed twice.

3.4 **Specific bank charges and levies**

Banks are currently subject to six different charges and levies: two regulated at European level, the contribution to the Deposit Guarantee Scheme and the contribution to the Single Resolution Fund, and four regulated at the Belgian level: a financial stability contribution, a tax on savings deposits (abonnementstaks/ taxe d’abonnement), a tax on credit institutions and the so-called “NID tax”. Together, they amounted in 2015 to 0.12% of banks’ total assets and about 25 to 30% of their profits (after tax) (see table in Annex).
The total of these six different charges and levies seems to be somewhat higher than in most other EU countries, although no information is available on the corporate taxes effectively paid by banks across countries.

The HLEG is of opinion that:

1. The four taxes regulated at the Belgian level should be reviewed by the authorities based on the following principles/objectives:
   
i  reduce fragmentation and complexity by making the overall framework more transparent;
   
ii  enhance the targeted character of the system;
   
iii  take due consideration of the proportionality and especially of the systemic character of larger institutions compared to smaller ones.

2. Experience in other European countries could be valuable for a review of the current taxation system.

3.5 Tax rulings

Rulings are an important instrument to provide longer-term certainty concerning the tax treatment of investment but have recently come under criticism.

Transparency of excess-profit rulings is essential for public acceptance of this tax instrument, which should only be applied in a non-discriminatory manner and when the benefits in terms of employment creation and value added generation are clearly demonstrated.

In this context, the HLEG recommends increasing transparency of tax rulings which could serve as an alternative to specific tax arrangements. One should also keep in mind that most of the time developing new activities on the back of specific tax or regulatory arrangements proves short-lived and counter-productive. Such mechanisms run the risk of contravening EU competition rules as recently experienced in Belgium and other EU countries, and also frequently introduce distortions in the functioning of the economy and the efficient allocation of savings and might raise some questions in terms of social fairness.
Recommendation 4: Mitigating excessive risk-taking behaviour

1. **The issue**

Since the crisis, a number of measures to limit risk-taking behaviour in the financial sector have been taken, in particular at the structural level and with respect to remuneration. However, there is still a need to restore public trust in the financial services industry and to take measures that foster financial integrity and reduce the risk of excessive risk-taking behaviour.

2. **General principles**

The HLEG decided to focus on a number of areas in which further measures could be taken with a view to positively influencing behaviour and financial integrity.

   1. **Importance of corporate culture.**

   The HLEG would like to stress that corporate culture has a significant effect on risk behaviour in the financial industry. The main indicators of a sound risk culture are as follows:

   - boards and management must set the expectation of integrity in behaviour (tone set from the top);
   - staff must expect to be held accountable (accountability);
   - internal culture should be such that it fosters communication and discussion (effective communication and challenge); and
   - financial and non-financial incentives must be consistent with the firm’s core values (incentives).

   2. **Emphasising individual accountability.**

   Currently, the Belgian financial sector does not have a single code of conduct with general application. There are a few codes with a limited scope of application but only financial institutions are a party to them, not individual staff members. In the UK, a new independent professional body, the Banking Standards Review Council (BSRC), has been set up to raise the standards of behaviour and competence in the industry and this is an avenue worth exploring. A more far-reaching approach can be found in the Netherlands. Through a mandatory bankers’ oath, bankers commit themselves to a code of conduct and the disciplinary rules that come with it. Enforcement of the disciplinary rules is the responsibility of the Stichting Tuchtrecht Banken.

   3. **Restricting access to the professions in the financial sector through certification, examinations and/or a professional institute.**

   Currently, Belgian law does not provide for general access restrictions to professions in the financial sector. A number of functions in the financial sector are nevertheless regulated, including (but not only) board member, management committee member, independent control function and effective leader in financial institutions, external auditors, as well as intermediary in banking and investment services and stockbrokers. For each of these positions, the regime is different and is reflected in various degrees of regulation, ranging from light regimes to heavily supervised ones. These regimes could serve as a source of inspiration for broader restriction on access to the professions in the financial sector like the UK Senior Managers and Certification Regime. Another example is the approach taken by the Belgian Private Bankers Association, which certifies people who demonstrate that they
are professionally active in private banking, attend the Association’s courses and pass the relevant examination. Private bankers who pass the Association’s test are allowed to bear the title of “Certified Private Banker”. Another example is the status of “Compliance Officers” who need to be approved by the FSMA after having passed exams organised by the Febelfin Academy. This regime could be extended to a wider section of the financial industry (e.g. the insurance business) where deemed appropriate.

4. **Review, improve and extend current “fit and proper” reviews.**

The whole “fit and proper” review process should be strengthened to ensure that boards of directors and management committees in financial institutions continue to be of high quality. Currently, the process is heavily skewed towards an assessment at the start of the recruitment process. There is little on-going assessment once a board or MC member has been appointed. More emphasis should be put on on-going assessments to raise the accountability awareness of board and committee members and they should not be limited to formal breaches of regulation but should also include behavioural aspects.

5. **Fine-tuning of remuneration rules in relation to sales targets.**

Consumer trust and confidence in financial services is essential. The way sales staff is paid influences what they sell to customers. The FSMA has already investigated the use of commercial targets in the sector and found that use of targets per individual, per office or per cluster of offices (including “offers of the month”) was widespread. The FSMA has since published guidelines on the subject. It may be necessary to take this a step further and to impose mandatory rules.

6. **Promote independent financial advice.**

Since 2014 a new status has been created for the provision of independent financial planning advice to non-professional clients (Law of 25 April 2015). This comes on top of existing regulation on the provision of intermediary services for mortgage and consumer credit financing. In order to improve the general public’s financial sophistication, the HLEG supports the development of such advisory financial services. However, it would be in favour of developing and promoting the profession of “Independent Financial Advisor” (instead of “Planner”) in order to reach out to a wider audience. Ideally, a small-scale advisory financial service should be developed that is directed at the general retail public.

3. **Specific recommendations**

Based on the general principles outlined above, the HLEG makes the following specific recommendations to further improve financial integrity and restore the public’s trust in the sector:

1. Governance and corporate culture: the supervisory authorities should be empowered to put more emphasis on the establishment of a strong risk culture within financial institutions. The supervisory authority should make more frequent use of its “right to attend” board meetings as observer in order to evaluate behaviour (but not judge content).

2. Emphasising individual accountability: the Belgian financial sector should be requested to develop and impose an industry-wide code of conduct to which individual staff members must adhere. The HLEG is also in favour of going one step further and introducing a regime similar to the Dutch
bankers’ oath instead of relying on a self-imposed code of conduct. This requires creating a legal basis for this oath.

3. Improving institutional accountability: a new independent professional body comparable to the Banking Standards Review Committee in the UK should be established. It should be independent from government and from industry associations (e.g. Febelfin). It should be set up by the industry itself with the aim of disciplining the sector through peer pressure and publicity. Its task should consist of monitoring adherence to a general code of conduct and acting as disciplinary institution to sanction compliance with an oath regime. It should also offer programmes of continuous improvement in culture and competence and report publicly each year. Moreover, it could be tasked with certain certification requirements (see below).

4. No general access restrictions but additional certification: the HLEG is not proposing to introduce general access restrictions as it is difficult to regulate in practice given the wide variety of roles and functions in the sector. However, it is recommending the extension of certification programmes such as the “Certified Private Banker” or the “Compliance Officer” (currently approved by the FSMA) to other important roles within the financial industry (including institutional asset managers). This type of certification could be carried out by the independent professional body recommended above under the supervision of the FSMA or the NBB as the case may be.

5. “Fit and proper” assessments: the HLEG proposes to extend the current “fit and proper” assessment of members of boards of directors and management committees to cover not only the inception of the mandate but also operate on a regular basis. This assessment should not only cover individual expertise but also ensure complementarity of expertise on boards and committees.

6. Sales targets and remuneration: the HELG recommends imposing a general ban on links between sales targets and (variable) remuneration.

7. Independent Financial Advisors: in order to reach a wider audience, the HLEG suggests developing and promoting, in parallel with or in replacement of the “Financial Planner” status, a profession of “Independent Financial Advisor” that would be targeted at the general retail public. The profession should be supervised by the FSMA.
Recommendation 5: Assessing and limiting the risks of the financial sector for public finances

1. **The issue**

During the financial crisis, public authorities in all affected countries, including Belgium, massively intervened to safeguard financial stability and limit the impact of the crisis on the real economy.

In Belgium, direct state support to financial institutions – as a percentage of GDP – was somewhat larger than the euro area’s average due to the failure of large cross-border institutions. There are two facets of state support to Belgian financial institutions: (i) guarantees provided on funding and assets (also called “asset relief”) and (ii) capital injections or outright nationalisations. Such support remained contingent on approval by the European Commission, being in charge of policing state aid within the European Union. In general, Commission approval of state aid to distressed financial institutions was associated with strict requirements in the shape of restructuring plans, appropriate to the degree of seriousness of the issues to be addressed and the size of state support.

The rescue of cross-border financial institutions highlighted the complexity of intervention in the absence of unambiguous European rules. The recession stemming from the financial crisis substantially increased the cost for Belgian public finances over and above the costs of bail outs.

In response to the financial crisis, EU countries agreed to set up a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM), encompassing a European Resolution Fund (ERF), to help minimise cross-border externalities. The new European resolution framework, which also includes the Banking Recovery and Resolution Directive (BRRD) and introduces bail-in instruments, should also help reduce the need for bail-outs and hence the cost to taxpayers of financial crises.

Despite the new European framework and the lower probability of recourse to national taxpayers’ money in the event of a financial crisis due to a shift towards bail-ins, the risk of bail-outs financed by national budgets cannot be removed altogether in the future for several reasons.

- Firstly, due to the absence at the moment of a common fiscal backstop, the ERF’s funding capacity remains foremost a line of credit granted by the ESM.
- Secondly, in a systemic crisis, the existence of bail-in provisions may exacerbate the risk of a bank run in the period immediately preceding the governing bodies’ decision to implement them. In case of a systemic crisis, these bail-in provisions might also deter member states from taking measures to clean up the balance sheet of the banking system.
- Finally, “less significant institutions” (LSI), i.e. those not directly supervised by the ECB acting as single supervisor, will in any case remain under a nation’s own bail-out/bail-in umbrella, although for these institutions the usual insolvency procedures should be applied in normal times.

2. **General principles**

With a view to reducing risk to taxpayers, the HLEG adopted the following principles to guide its specific recommendations:

1. **The need for a specific bail-out capacity measurement**: the bail-out capacity of a state is a crucial type of information needing to be properly assessed.
2. The need to define correctly the contribution of the financial sector to a nation’s GDP: assuming that GDP is used as a proxy for a nation’s bail-out capacity, the figure for the financial sector’s contribution to GDP needs to be properly assessed. This is particularly relevant in times of crisis when provisioning for loss should not be counted as a contribution to GDP.\textsuperscript{14}

3. The need to centralise in a single entity (1) the management and oversight of state guarantees and (2) capital injections into the financial sector. This is crucial to ensure sufficient coherence and coordination of state actions in Belgium.

3. **Specific recommendations**

Taking into account the new European framework for bank recovery and resolution, the HLEG recommends additional specific measures enabling the Belgian authorities to better assess the risk incurred in the future by Belgian public finances (at federal and regional levels) relative to the financial sector:

1. **Introducing regular stress testing to assess the risk to Belgian public finances** relative to the financial sector

   Belgium should have an authority in charge of performing stress tests on the basis of different scenarios to assess the resilience of the financial sector as a whole on a yearly basis and the potential costs for public finances (and budget resilience), including both explicit and implicit guarantees.

   When estimating potential guarantees, this authority should, inter alia, take the following elements into account: the amounts of loans likely to be allocated in a salvaging effort, the amounts of insurance benefits likely to be guaranteed and subsidies (capital injections) that will be granted to the regulated or non-regulated sector, should a major financial crisis break out once again.

   When implementing the required stress tests, the interconnectedness of the Belgian financial sector should be properly mapped and weighted out in terms of potential contagion, and the costs of any likely spill-over due to correlation in behaviour of different markets.

   The HLEG recognises the difficulties of undertaking this type of exercise particularly in measuring contagion and interconnectedness and recommends developing such stress testing in sequential phases over the coming years.

\textsuperscript{14}The assessment of the financial sector’s contribution to GDP should therefore not resort to the currently used so-called FISIM (Financial Intermediation Services Indirectly Measured) methodology as at times of crisis this provides a grossly over-optimistic view of the state of affairs. FISIM ignores risk and the possible (and most likely) embedding of a risk premium - acting as a provision against loss - within the interest rate of a debt instrument: the rising credit risk premium implicit in the interest rate charged to clients is indeed computed as added value instead of loss reserves as it should logically be. FISIM therefore grossly miscalculates the contribution of financial intermediation in crisis times. Gross value added is measured for intermediation activities as loan amount times the difference between interest rate charged and cost of funds, cost of funds being defined here as risk-free and benchmarked at a nation’s global level. Any element of a risk premium embedded in the interest rate charged is thus regarded as returns contributing positively to the economy, with the paradoxical consequence that the more shaky economic circumstances are, the larger the contribution of the financial sector to GDP will supposedly be - the provisioning of forthcoming potential loss being accounted for as gross value added.
2. **Consolidating into a single entity the monitoring of state support to the financial sector**

The HLEG recommends that the Belgian governing bodies consolidate the monitoring of all state interventions (guarantees and participations) to the financial sector into a single entity. This would allow authorities to have a comprehensive view on all relevant facets of the various financial institutions, especially in terms of risk and strategic decisions. This would certainly contribute to enhancing the decision-making process with respect to financial institutions benefiting from state guarantees and/or state participation.

This entity could be based at the Finance Ministry since the Debt Agency already keeps an exhaustive list of explicit state warranties. This list should be complemented by an estimate of the cost for Belgian public finances of guarantees granted by EU-level resolution and recovery bodies.
Recommendation 6: Financial innovation and public policy

1. **The issue**

Banks occupy a pivotal position in the Belgian financial landscape and in the real economy: they ensure a substantial part of external funding for companies, in particular SMEs, and hold directly or indirectly a substantial part of households’ savings. This structurally high reliance of the financial intermediation process on the banking industry results from two main elements: (i) the tax treatment of savings deposits, and (ii) the structure of the real economy dominated by SMEs.

The dominance of universal banks in sourcing funding for the private non-financial sector has hampered the development of alternative financial players and instruments, in particular those more supportive of direct market-based finance. The strong concentration of financial intermediation in a limited number of financial institutions exposes the economy as a whole to shocks in the banking system and potentially limits the availability of alternative funding sources for the real economy. This lack of funding diversification for the corporate sector is not optimal since it exposes the Belgian economy to potential dangers for the welfare of its population.

The existence of a concentrated banking industry dominated by universal banks – following mergers and acquisitions in recent decades –, with excessively large networks, might also slow down somewhat innovation in the area of financial services. Therefore, improving the productivity of the banking sector and creating conditions for the entry of new players and the development of new financial technologies may provide important opportunities to diversify the funding of the real economy and hence mitigate the potential downside risks implied by a highly concentrated banking sector. Low entry costs to allow new entrants and/or specific investment instruments are crucial here. It is important, however, to avoid regulatory arbitrage.

2. **General principles**

For a variety of reasons, including digitisation, downsizing of the domestic network of Belgian banks is inevitable. It would also increase productivity and help to make the banks more cost-efficient.

The necessary diversification of the sector can occur at the level of financial intermediaries (a more diversified and less concentrated sector) as well as funding sources/instruments (more market-based finance). In order to rest on solid and stable grounds, the development of new financial activities and instruments should be geared towards the funding and diversification needs of the real economy.

The following general principles for the reform of the financial sector and the development of a financial ecosystem more conducive to innovation are put forward by the HLEG:

1. **The reform and transformation of the financial sector should be integrated into and consistent with the on-going reforms at EU level.** In particular, the process of deepening European financial integration through completion of the Capital Markets Union (CMU) could become an important driver of reforms towards a more balanced financial landscape. The Belgian authorities should play an active role in this process to help shape specific initiatives and priorities and the transposition of EU Directives should be transparent and fast to profit from the first-mover advantage.
2. Gradually removing tax distortions, entry barriers and other market failures/imperfections in the Belgian financial system could stimulate innovation as well as enhance diversification and diversity of the financial industry. This should nevertheless be done with due concerns for financial stability, i.e. phasing in over an appropriate transition period in order to allow the industry to gradually adapt its business model. Care should be taken to avoid too much fine-tuning of administrative conditions and/or tax regimes for each specific instrument or financial niches (see recommendation 3). Excessive fine-tuning (e.g. tax-targeting) potentially generates unwarranted complexities that may result in (counter-productive) confusion and distortions in the market.

3. In this context of creating a supportive ecosystem for the financial sector, it is important to have a stable, predictable and supportive legal and regulatory environment. To this end it is advised to benchmark the Belgian legislation and administrative processes to the best practices in the European countries where relevant financial instruments/activities are already well developed.

3. Specific recommendations

The HLEG proposes some specific recommendations to stimulate further diversification of the financial intermediation process in Belgium; they pertain both to expanding the variety of funding instruments, especially those for SMEs, as well as encouraging new types of players to take on a more prominent role in the intermediation process. They are not intended to be exhaustive but are in general indicative of the two directions in which the HLEG sees room for improvement:

3.1 Improving the efficiency and productivity of the banking and insurance sector

Digitisation will change the whole structure of the financial sector. In this context and given that there is room of manoeuvre to reduce certain inefficiencies in the banking and insurance sector in Belgium, the HLEG recommends institutions to further review their business models and take the necessary measures to enhance their efficiency taking into due consideration major revolutions stemming from digitisation and financial stability concerns.

3.2 The development of alternative financial instruments

On the funding side, there is room for additional financial instruments to help diversify financing of the corporate sector and the real economy. In particular, the creation of (small-scale) debt instruments (e.g. Schuldscheine) and the securitisation of receivables are instruments that could be very helpful for the corporate sector and SMEs in particular. Schuldscheine for instance allow SMEs to access the capital markets without going through onerous rating, prospectus and other regulated processes. They would also give alternative investment and diversification opportunities to investors, such as pension funds and insurance companies, to address the ageing of the population. Even asset managers could also play a role as is the case in Germany.

In view of the lack of appropriate instruments in Belgium, the HLEG specifically recommends that:

1. the Belgian government considers encouraging direct intermediation through securities markets by promoting some instruments – such as simple and transparent securitization (recently approved at the European level) or Schuldscheine - to improve their attractiveness to the financial sector and to the investors. In this context, the HLEG welcomes the recent initiative by the EC to allow for a preferential regulatory treatment for (simple and transparent) securitised assets in the balance sheet of insurance
companies. A further step could be to support initiatives at the European level to allow for a preferential treatment for direct loans to SMEs by insurance undertakings as in the European banking regulation (CRR/CRDIV). This would support SME financing and ensure more level playing field between insurance companies and banks.

2. the Belgian government considers re-activation of the securitisation market by improving the necessary conditions for deepening the market. The development of a secondary market for securitised (simple, high-quality) products can be supported by reducing and simplifying administrative constraints (prospectus and limits) to make the use of private placement of debt more attractive and less cumbersome. The development of a market for asset-based securities, where the underlying assets are loans to SMEs, could also help improving SME financing. Business angel and banks may play an important role to bring together suitable investors and small businesses.

3. additional efforts are made to enhance the leverage and scale of crowdfunding instruments by reviewing the current legislation and benchmarking it on the best practices in neighbouring countries. Raising and differentiating the specific borrower and lender investment limits depending on the riskiness of the various crowdfunding instruments is one possibility to lift some of the constraints on the growth potential of this broad-based source of financing.

3.3 The development of alternative financial intermediaries

A similar approach should be followed in the case of financial intermediaries: the experience with pension funds, Bevaks and REITs (geregelmenteerde vastgoedvennootschappen), that have worked well in Belgium, illustrates the importance as well as the potential of regulatory transparency and simplicity, a stable and uniform level of taxation and simple administrative processes.

3.3.1 Pension funds

As a result of targeted regulation and the presence of a large number of multinationals in Belgium, the domestic pension fund industry seems to have become more attractive for foreign companies, particularly for cross-border pension funds within multinationals. Further improvements to the framework, including addressing some unintended consequences involving double taxation, are important elements for developing a more competitive international asset management industry in Belgium.

The HLEG considers that a number of measures could be taken to reinforce earlier initiatives to attract pan-European pension funds. Specifically, the HLEG recommends that:

1. additional efforts are made to facilitate the entry of these funds by lowering the start-up costs (administrative, legislative,...). In view of the complex social and tax legislation implied by such cross-border activities and potential unintended consequences, single entry points providing logistic and legal services in the start-up phase of these pan-European funds could be considered (set-up, legal and social legislation, regulatory framework, tax regime, etc.).

2. the legal implications of setting up pan-European pension funds should be thoroughly reviewed and if necessary rectified; in particular those related to double taxation of pension payments outside Belgium or by removing the special social contribution on foreign pensions, which will not benefit from the Belgian social security system.
3.3.2 **Long-term infrastructure funding**

Budgetary constraints and regulatory changes for banks and insurance companies have weighed on long-term infrastructure investment by the public authorities. Insurance companies and pension funds have looked to provide alternative funding by pooling funds across several companies. This could provide interesting opportunities for the bank/insurance model. While demand might be lacking at the current juncture, the regulatory treatment remains uncertain and might prevent the development of this formula.

A recent EU Regulation\(^\text{15}\) provides a general framework to stimulate the development of such long-term investment funds, European Long term Investment Fund (ELTIF), to support the real economy. They would help diversify the financing of the economy and tackle different challenges that the public sector cannot address owing to budgetary constraints.

In this context, the HLEG recommends:

1. The authorities to encourage market participants in Belgium to develop ELTIF and to assess the possibility of developing an expertise centre in this area in view of the future needs in long-term funding in Europe. This will require keeping the administrative and regulatory processes as simple and short as possible and ensuring a stable tax framework.

2. The HLEG encourages the different authorities (Regions/Communities/local authorities) to collaborate more actively in this area in order to enhance the economies of scale of such projects.

3. The HLEG welcomes the recent decision by the EC to facilitate investments by insurance companies in ELTIF and to classify long-term investments in qualifying infrastructure projects (SPV) as a class of safe assets. Pension funds could also play a role in promoting ELTIF in Belgium in view of their long-term business model.

4. The HLEG recommends the competent authorities to support the extension of the preferential regulatory treatment for insurance undertakings for corporate investments in infrastructure.

5. The HLEG recommends the competent authorities to support an alignment of the prudential treatment of loans guaranteed by the regions communities or local authorities with the treatment of loans guaranteed by the Federal authority (insurance companies).

3.3.3 **Private equity funds**

Equity funding is an important factor not only for financing the economy but also for providing sufficient capital buffers to absorb shocks and obtain bank lending. It is to a large extent crucial in both the start-up phase for many SMEs and in the growth phase and their internationalisation strategies. It is generally perceived that there is sufficient supply of risk (equity) financing in Belgium, but not necessarily in each segment of the market. Existing private equity funds generally tend to be small and are therefore unable to participate in larger capital rounds or successive capital rounds which may be particularly relevant in the

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\(^\text{15}\) The ELTIF Regulation was adopted on April 29, 2015 and came into force on June 8, 2015. It applies from December 9, 2015.
growth phase of companies. The larger funds that existed before the crisis were all linked to banks and have all disappeared as a result of the high regulatory charges linked to equity financing.

Increasing the scale of the funds would allow a more long-term approach of successive capital injections instead of the stop-go approach that smaller funds generally follow. Larger funds can also attract more experienced professionals who can help in the development of new companies.

Larger funds can be obtained either by allowing stronger internal growth of existing funds, either by consolidation or by stronger emphasis on co-financing and public-private partnerships. It is important that the public input concentrates on the financing, particularly in the early phases of the investment cycle, and not on the expertise.

As equity financing/investment cycles in corporations are typically long-term (generally over 5 years), it is crucial to provide a stable and predictable environment to private equity funds as well as strong enough incentives for equity financing.

In this context, the HLEG recommends:

1. introducing a more neutral tax treatment of funding, aiming at a more balanced approach between equity and debt financing. The current system still (excessively) favours leveraging over equity financing. In this context it is advised to maintain and even expand the system of notional interest rate deductions (at least for non-tax evasion activities) and alternative systems, such as EIS (see below) or rulings.

2. establishing a stable framework (including tax regulation and administrative requirements) that is transparent, predictable in the longer term and provides sufficient future prospects for the sector. This requires a continuous dialogue with the financial (private equity) sector.

3.3.4 Enterprise Investment Schemes (EIS)

Enterprise Investment Schemes (EIS) have been set up in some countries, particularly in the UK, as a means of raising (equity) finance for SMEs using tax relief. Such schemes, through tax relief, provide implicit subsidies to induce investment (direct or through investment funds) in specific types of high-risk SMEs or start-ups that would not (or not sufficiently) be provided by the market.

In Belgium, there is no large-scale, general, EIS system to date. Instead, different support schemes for young and innovative enterprises co-exist, but are often fragmented across the Regions and rather complex.

In this context, the HLEG recommends:

1. increasing the scale/reach of the existing support schemes by harmonising, simplifying and integrating the different (support) systems into a more general and transparent system to create a larger pool of funds that could be used to finance larger or longer-term risk projects. This will require coordination with the regional authorities.

2. looking into the possibility (and costs) of introducing the EIS system at federal level to promote private equity and venture capital investment either through direct investment or through EIS investment funds. The recent “Start-up” plan by the federal government, implementing an EIS-like
investment scheme at a smaller scale, could serve as a prototype to be monitored before introducing a fully-fledged Belgian EIS.

3.4 Consumer protection

Simple and transparent regulation is sometimes considered at odds with the requirements of consumer protection. Experience in a number of European countries illustrates that this is not necessarily so. An unduly restrictive regulatory framework may lead to an arid financial landscape.

In this context the HLEG recommends:

1. improving financial literacy and making investors better aware of the inherent risk in certain financial products rather than restricting the use of certain products. An interesting complement to improving the overall financial literacy of consumers is the establishment of Independent Financial Advisors who could bridge the knowledge gap between issuers and final investors (consumers) and point to potential conflicts of interest between the issuer of financial products and the interest of the consumer. See Recommendation 4.

2. In addition, an in-depth reflection should take place on the quality, quantity and effectiveness of the financial information currently provided to consumers.

3. The public authorities to consider prohibiting the sale for consumers of certain new instruments which are designed for institutional investors (e.g. hybrid instruments issued by banks or insurance) in view of the risks they entail.

4. Due attention should be given by regulators and supervisors to the need to set up trading platforms that are transparent and inform prospective “small investors” of any potential risks involved in the different trading instruments.
Recommendation 7: A balanced use of gold plating

1. **The issue**

Gold plating refers to a situation where Belgian law or Belgian regulatory practices go beyond, or continue to exist alongside, the requirements of EU or euro area regulations and impose additional costs or burdens upon financial institutions doing business in Belgium.

Gold plating has been raised as a key issue by most parties interviewed by the HLEG. Respondents objected to the direct and indirect cost of compliance, as well as the time-consuming nature.

Potential or current gold plating examples in Belgium include for example, for good or for bad,

i) limits to trading for banks and structural reform;

ii) caps on remuneration,

iii) liquidity and large exposure requirements

iv) governance regulation such as on number of directorships or gender balance on boards of directors,

v) consumer protection, such as offering prospectus requirements,

vi) capital weighting of holdings of sovereign bonds by banks,

vii) additional disclosure requirements for insurance companies contemplated in the new draft law.

In a number of cases, Belgian regulations exist where international regulations are still in the making, such as on structural reform for banks or a Directive on recovery plans for the insurance sector, or they may simply continue to exist alongside international regulation.

There is a need to strike the right balance between the additional regulations aiming at financial stability on the one hand and a sustainable and competitive financial sector on the other. For instance, Belgian remuneration caps apply to subsidiaries abroad of Belgian banks which themselves are a subsidiary of a foreign group parent, but not to those which are direct subsidiaries of the foreign group parent. This merely creates an incentive within such a group to transfer some subsidiaries from under the Belgian intermediate holding to the group parent itself. Similarly, some members of Belgian-based staff in non-banking jobs within market infrastructures are handicapped in terms of remuneration vis-à-vis their peers abroad.

At issue is the question whether international regulations offer enough protection for the public and consumer interest, or whether Belgium should go further and impose additional burdens on the financial industry. This merits a cost-benefit analysis.

A key factor to take into consideration in relation to prudential regulation is general governance and especially which entity, the Belgian State or some supranational entity, bears the financial risk in case of failure. Valid arguments could be made for gold plating if the international framework is deemed to be inadequate and the financial liability remains with Belgium. This is the case with the European banking union which remains
incomplete but where great strides have been made, and even more so in the case of insurance where international regulation imposes standards that often fall short of those practised traditionally in Belgium. Nevertheless, as the European project advances, one would expect the need for national gold plating to abate over time.

2. **General principles**

At the current juncture, we see less ground for gold plating for prudential regulation in the Belgian banking sector given the progress in establishing a true banking union, although an important pillar is still missing (the Deposit Guarantee Scheme), and the resolution fund is not yet fully mutualised.

Whilst considerable progress has been made in recent years in regulation and supervision for the banking sector and in consumer protection, for other sectors such as insurance and shadow banking - gold plating might still be acceptable given the lack of common institutional and regulatory framework and given the strong market fragmentation.

- In insurance, the forthcoming Solvency II regime, although a large step forward in regulation, may not satisfy some in Belgium and might justify additional regulatory and/or supervisory intervention. Added to the relatively lenient rules on solvency itself during the transition period, the potential widespread use by insurance companies of complex models - allowing them to cherry pick the least capital requirements, as has been observed in the banking sector under Basel II.

- Shadow banking activities/entities may also merit additional attention and supervision. Ideally, in view of the cross-border nature of these entities, action would be required at international rather than national level. In the absence of any proper international framework, measures could be envisaged at the Belgian level to limit any possible contagion from this non-regulated sector to the rest of the Belgian financial sector in case of difficulties.

With regard to gold plating in the area of consumer or investor protection, a trade-off is to be made between protection and availability of products and services.

3. **Specific recommendations**

Gold plating should be the exception, rather than the rule and should in each case be based on a cost-benefit analysis under a ‘comply or explain’ regime.

As regards financial sector regulation, the HLEG recommends:

1. clearly identifying in any new draft legislation deviations from the relevant international rule, e.g. directives;

2. wherever possible, using Copy-Out, i.e. verbatim copy directives to ensure consistency and avoid unnecessary discrepancies;

3. assessing the costs and benefits of each proposed gold plating for the short and longer term both for the financial sector and for the real economy, in an Impact Assessment Report, taking into account a quantitative impact assessment if possible;
4. regarding the implications for financial stability of the envisaged measures, an ex-ante consultation of the national macro-prudential authority;

5. analyse any international experience in the same field, especially whether similar measures are applied in other member states and the impact of these or similar measures when they have been applied;

6. benchmarking supervisory practices, such as the length of time to get approvals, against Belgium’s main competitors; envisage appropriate transition periods before implementing more stringent measures than in other EU countries; and going forward monitor the impact at regular intervals – e.g. the UK imposes a recurring 5 year review - both for the sector and for the real economy, including in view of the further institutional progress leading to further alignment of responsibilities or in view of new regulatory and supervisory developments at the EU or euro level (e.g. structural reforms on trading by banks, the possible forthcoming review of the prudential treatment of sovereign bonds held by banks,...).

With respect to regulatory practices the HLEG recommends to consider benchmarking actual practices through selected key-performance indicators (KPIs) against best practices.
Recommendation 8: Digital transformation of financial services and promoting growth of FinTech

1. Issues

The financial sector is undergoing rapid change as a result of the digital transformation of financial services and the development of new financial technologies (“FinTech”). Digitisation refers to the ongoing wave of technological innovation induced by the combination of the proliferation of mobile devices, the use of internet-based technologies and leverage of big data analytics. Digitisation and innovation present opportunities as well as the potential for disruption if the financial sector does not manage to stay ahead of, or at very least, stay on the curve.

First, digitisation will cut the cost of payments (in real time), and improve efficiency – which is seen as relatively low in the banking industry, in view of the relatively high number of branches and out-dated IT structures. Second, new entrants – very often entities that were not active in the financial sector until now – are becoming increasingly active in segments that traditionally were the exclusive domain of the financial sector (e.g. payments, lending, wealth management, etc.). These new entrants have been quick to exploit changing customer demands for seamless access to financial services through the technology/device of their choice. Unlike traditional players in the financial sector, they are not hindered by costly legacy structures and branch networks but are still more customer-focused rather than product-oriented and able to offer integrated solutions.

The financial sector could make more use of digital analytics like big data to enhance their understanding of their customers’ needs to allow for the development of new service models and new business opportunities.

Belgium has historically been one of the leaders in new technologies supporting the financial sector. This has been the case in areas like electronic payments, financial messages, securities settlement systems, but also in security practices for financial transactions.

A number of flagship institutions like Euroclear and Swift are located in Belgium, and several other FinTech start-ups or university spinoffs operate in Belgium. What is lacking in Belgium, however, is a culture or environment to actively stimulate the growth of FinTechs and nurture national champions beyond the initial start-up phase. Also, important financial institutions currently located in Belgium may relocate part or even all of their activities if Belgium’s attractiveness does not improve quickly.

Finally, digitisation creates new risks such as cyber security (see recommendation 9). Any security breach can be very damaging for the targeted institution, but also for the whole financial ecosystem. Digitisation could also lead to greater interconnectedness and thereby increase contagion risks sharply.

2. Recommendations

Belgium should foster an ecosystem in which FinTech start-ups, payment systems, universities and the financial sector can easily develop new initiatives and interact.

Such an ecosystem can only become sustainable if all actors have sufficient interests at stake that together have a reinforcing effect. There are clearly weaknesses that have to be addressed. On the other hand, our recommendations aim at seizing opportunities where more cooperation can be initiated by good policy-making. In particular, the HLEG recommends the following:
1. **Universities**

Fragmentation of efforts and lack of focus in the area of finance by Belgian universities has resulted in insufficient quality and quantity of finance degrees compared to other financial centres (e.g. Amsterdam, Luxembourg, Paris). The HLEG would welcome more focus and cooperation in this area, both for graduates and Masters Students. A broader talent pool would raise the potential of spin-offs which can trigger more FinTech companies and therefore fuel the ecosystem.

2. **Payments systems**

A total cashless society is utopia in the foreseeable future, but Belgium should try to remain a leader in digital payments.

In this respect, the public sector should set the example by becoming as cashless as possible and digital in its payments. More cooperation between financial institutions on a common payment platform would be more efficient and beneficial for the industry and still allow for a differentiated treatment of their customers, but it should not lead to the exclusion of new entrants. The Belgian Competition Authority should be vigilant about this.

3. **Start-ups and new products**

   i. We invite the FSMA to assess the barriers to entry for new players, compared to neighbouring countries.

   ii. Legislation is often written in the context of older payment and ICT systems, and should be upgraded where necessary in order to be consistent with digital initiatives. We therefore welcome the Digital Act initiative by the federal government.

4. **FinTech centre**

The government should not take over the role of the entrepreneur. However, the public sector could facilitate some initiatives and entrepreneurship by the following measures:

   i. A minimum percentage of public procurement contracts that target FinTech companies could be allocated to young companies.

   ii. Ensuring timely paying of invoices to young companies by the public sector.

5. **Privacy and big data**

National privacy and data protection laws should be modernised where necessary to allow for big data analytics that is beneficial for the customer and society at large, such as customers’ needs, enhancement of risk analysis, fraud detection. European legislation should be adopted pro-actively without gold plating.
6. Promotion of the Brussels financial centre

A consistent presence and structured promotion of the financial industry in international trade missions, Davos and other high-level international events should be arranged.

7. Business ethics in the financial centre

More could be done to improve the image and reputation of the Belgian financial sector in particular as regards business ethics (see also recommendation 4). It has been reported to the committee that from an international perspective the Belgian financial market place, rightly or wrongly, is perceived as too lenient on ethical standards. Such negative perception should be reversed by all means.

Other specific measures that would help promote the Belgian financial sector have also been detailed in recommendation 6.
Recommendation 9: Making cyber security a core strength of the Belgian financial ecosystem

1. The issue

Cyber security has become an important focus for management throughout the economy. Recent research\textsuperscript{16} has shown that most Belgian companies have had security breaches, despite following current IT best practices. 80% of the companies surveyed had malware running on their network. This malware was actively communicating with the internet. 88%\textsuperscript{17} of the companies do not believe that their information security structure fully meets their organisation’s needs.

After some high-profile ICT security breaches in Belgium in recent years, both in the public and private sectors, it is clear that Belgium should improve its cyber security significantly.

The financial sector is not shielded from cyber security threats. The impact of any breach is of course larger in this sector than elsewhere given the importance of confidence in the financial system. Given the systemic consequences, especially with the presence of international financial infrastructure, this is a responsibility that has national and international defence consequences.

Two developments are particularly important:

- Firstly, cyber security has become a financial stability issue. Cyber security is no longer a pure ICT problem. Cyber incidents could have a systemic impact should certain financial processes be interrupted and/or the public lose confidence in the integrity of a particular systemic financial institution (e.g. because of identity or data theft, data compromise, or loss of access), let alone the system as a whole. This also implies that compromising on cyber security should not be used to achieve a competitive advantage over other institutions.

- Secondly, cooperation and in some cases pooling of resources (skills, best practices, critical information, shared solutions…) are probably desirable, at least up to a point. From the point of view of the financial sector, cyber security is an asymmetric problem: the cost to launch a cyber threat is substantially less than the cost to defend against it.

In the United States, the Department of Homeland Security coordinates with the public and private sector to share information and intelligence of cyber threats. In Europe, several countries like France (ANSSI) and the UK (CBEST) have recognised the importance of cyber testing and certification for their critical infrastructures, including the financial sector, and have launched initiatives to enhance resilience against cyber incidents. Belgium is following these examples.


2. **General principles**

We welcome the decision by the federal government to create a Belgian Centre for Cyber Security\(^\text{18}\). The High Level Expert Group believes that such a cyber defence authority should coordinate with both the public and private sectors, and especially the financial sector, to share information and analysis of cyber security and threats.

3. **Specific recommendation:**

1. Starting from the identification of critical functions and critical data, the cyber defence authority could evolve towards the definition of a common cyber defence norm taking into account international best practices and set minimum certification requirements based on risk profile, criticality, and materiality. Over time, widespread certification would bolster the reputation of Belgian financial institutions and avoid competition on risk.

2. In order to enhance Belgium’s cyber security resilience, the cyber defence authority would typically be active in the areas of prevention, protection, detection capabilities, responsiveness, investigation skills, and the ability to recover from cyber incidents.

3. Comparable to financial stress tests, the cyber defence authority could develop advanced but standardised penetration exercises. These exercises need to be practical, realistic, and correspond to how modern attackers are hacking into organisations. In the case of financial institutions, supervisory authorities should be informed on systemic weaknesses and request improvements.

4. Such a standardised cross-sectoral approach is likely to create incentives for resource pooling beyond the sharing of information and analysis. Mobilising and sharing available cyber security resources and skills across sectors, including the financial sector, and across institutions, both in the public and the private sectors, would create synergies to the benefit of all stakeholders involved and enhance Belgium’s cyber security resilience.

5. The current resources of the Centre for Cyber Security will have to expand significantly in the future to meet cyber challenges. In the process, Belgium could become a centre of expertise in this field. This implies making it a defence priority, along the lines of the new national defence long-term strategic plan. Part of the 400 million euro budget increase recently decided by the federal government to counter terrorism could be used to improve cyber security.

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Recommendation 10: The Belgian State's participating interests in the financial sector

1. **Issues**

   During the financial crisis, the Belgian State had to intervene in the financial sector to safeguard financial stability, limit the impact on the real economy of the banking crisis and protect depositors. As a consequence, the State is now a major shareholder in several significant institutions in the Belgian banking and insurance sector: it holds 100% of the share capital of Belfius NV/SA, 50.02% of Dexia NV/SA (which is outside the scope of this note), 10% of BNP SA and 25% plus 1 share of Ethias NV/SA. In each instance, the actual powers of the Belgian State are quite different.

   The State does not have per se a comparative advantage as a reference shareholder of these financial entities. However, all these institutions perform important functions in the Belgian real economy. The HLEG therefore recommends a review of the appropriateness of maintaining or reducing its holdings by taking into account a wide range of considerations (see below).

2. **Recommendations**

   The HLEG proposes four criteria that should be considered when assessing the impact of alternative strategies for the State's participations. But it does not provide relative weights for each of these criteria, since this is eminently a political choice that lies with the federal government.

   1. **Impact on the real economy**

      i. Maintaining strategic activities and knowledge centres in Belgium.

      ii. Impact of each alternative on the provision of critical/strategic services to the Belgian economy in areas such as payment services, credit to or insurance for households, the commercial sector and/or public authorities.

   2. **Impact on public finances**

      i. Net present value of the participating stakes to the Belgian State in the medium term, i.e. a reduction of the Belgian public debt versus impact on the budget of the loss of dividends;

      ii. reduction of the potential need of State intervention to bail out or guarantee funding (taking into account the new European bank resolution framework too); and

      iii. the impact on funding of the local authorities/public sector entities.

   3. **Impact on the structure of the Belgian financial sector**

      i. Impact on the structure of the Belgian financial sector, such as the level of competition and the profitability.

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19 The Walloon and Flemish regions also hold 25%+ 1 share each.
ii. Impact on the channelling of (excess) domestic savings deposits abroad. In the future, forthcoming EU regulations are likely to further facilitate intra-group transfers to foreign parent (or group) companies.

4. **Impact on employment and social cost**

   i. loss of skills and higher value added services;

   ii. loss of low-skilled jobs.
Annex - Illustrations

Macroeconomic environment

REAL GDP GROWTH
(year-on-year growth rates, percentage points, 2005Q1-2015Q2 and forecasts up to 2017Q4)

Source: NBB.

MFI INTEREST RATES AND MARGINS
(percentage points, 2005M1-2015M9)

Non-financial corporations

Sources: Thomson Reuters Datastream, NBB.

1 Difference between the MFI interest rates on loans to non-financial corporations, up to an amount of € 1 million, over 5 years initial rate fixation and the 5-year swap rate for the 6-month Euribor (monthly averages).

2 Difference between the MFI interest rates on loans to households, for house purchases, over 10 years initial rate fixation and the 10-year swap rate for the 6-month Euribor (monthly average).
CONSOLIDATED NON-FINANCIAL PRIVATE SECTOR DEBT
(% GDP, 2005Q1-2015Q2)

Households

Non-financial corporations¹

Source: NBB (National financial accounts).
¹ Loans and debt securities, excluding financial transactions between resident non-financial corporations.

DOMESTIC BANK LOANS TO RESIDENT HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS¹
(year-on-year percentage points, 2005M1-2015M9)

Source: NBB (scheme A).
¹ Data adjusted for securitisation.
HOUSEHOLDS ASSETS

Household assets: financial instruments
(% of total, 2015Q2)

Household assets: sectoral counterparts
(% of total, 2015Q2)

Source: NBB.

Household assets: Currency and deposits
(€ billion)

Source: NBB.
Financial sector

SIZE OF THE BANKING SECTOR
(total assets in billion, by type of institutions)

Source: NBB (unconsolidated data).
EVOLUTION OF BANKS’ ASSETS AND LIABILITIES (INCLUDING COMPOSITION)
(total assets in billion, by type instruments)

Source: NBB (consolidated data).

(2) Other assets mainly comprise cash balances at central banks, equity instruments, (in)angible assets and DTA’s. Other liabilities mainly comprise short positions, financial liabilities other than deposits and debt securities, provisions and defined benefit obligations.
TAXES – BANKING SECTOR
(in million €, November 2015)

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Sources: FPS Finances and Febelfin

GUARANTEED RATE OF RETURN ON CLASS 21 CONTRACTS (insurance companies)
(in %)

Source: NBB.

*Secondary market yields on Belgian ten-year government bonds (OLOs), weekly data.
BREAKDOWN OF LIFE INSURANCE INVENTORY RESERVES ACCORDING TO THE GUARANTEED RETURN PER INDIVIDUAL CONTRACT
(year-end 2013 and 2014, in € billion)

Source: NBB

EVOLUTION OF THE TOTAL ASSETS OF FUND INDUSTRY
(in € billion)

Source: NBB.
ICSDS and TOP 20 – EU CSDS: securities deposits
(in € billion at the end of 2013)

Source: ECB, Blue Book.
**Glossary**

**ANSSI:** Agence nationale de la sécurité des systèmes d'information (France)

**BRRD:** Bank Recovery and Resolution Directive

**Banking Union:** The banking union constitutes a response to the euro area crisis. It aims to ensure that the banking sector in the euro area and the wider EU is safe and reliable and that non-viable banks are resolved without recourse to taxpayers’ money and with minimal impact on the real economy. It is based on 3 pillars: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM), and the Deposit guarantee scheme (DGS). The European DGS has not yet been agreed at the EU level.

**BSRC:** Banking Standards Review Council

**Capital Market Union (CMU):** the CMU is a plan of the European Commission (EC) to mobilise capital in Europe and boost business funding and investments.

**CBEST:** Framework to deliver controlled, bespoke, intelligence-led cyber security tests (United Kingdom)

**CCP:** Central counter party

**CREFS:** Comité des risques et des établissements financiers systémiques (Belgium)

**CRR/CRD IV:** Fourth Capital Requirements Regulation and Directive

**CSRD:** Central Securities Depositories Regulation

**DGS:** Deposit Guarantee Scheme

**DSTI:** Debt service-to-income ratio

**DTI:** Debt-to-income ratio

**EC:** European Commission

**ECB:** European Central Bank

**EDIS:** European Deposit Insurance Scheme

**EIS:** Enterprise Investment Scheme

**ELTIF:** European Long-term Investment Fund

**ESFS:** European System of Financial Supervision

**EMIR:** European Market Infrastructure Regulation

**ERF:** European Resolution Fund
ESM: European Stability Mechanism is a crisis resolution mechanism for euro area countries. It provides financial assistance to euro area countries. Banks’ direct recapitalisation can also be conducted by the ESM under specific conditions.

ESRB: European Systemic Risk Board

EU: European Union

FinTech: Fintech refers to companies that provide financial services through the developments of new technologies.

FISIM: Financial Intermediation Services Indirectly Measured

FSAP: Financial Sector Assessment Programs (FSAP) is a comprehensive and in-depth analysis of a country’s financial sector conducted by the International Monetary Fund (IMF).

FSB: Financial Stability Board

FSMA: Financial Services and Markets Authority (Belgium)

Gold plating: Gold Plating refers to a situation where national law or national regulatory practices go beyond, or continue to exist in parallel with, the EU (or EA) requirements or regulations and impose additional costs or burdens upon financial institutions doing business operating in the domestic economy.

GDP: gross domestic product

GFSR: Global Financial Stability Report

HLEG: High Level Expert Group

ICSD: International central securities depository

ICT: Information and communication technology

IT: information technology

IMF: International Monetary Fund

IRB: Internal ratings-based approach. It refers to the model-based approach banks use to compute their prudential capital requirements.

“Korting”: Dutch expression for “reduction”. Situation of a reduction in pension benefits because of insufficient assets covering pension liabilities.

LSI: less significant institution

LTV: loan-to-value ratio

M&A: Mergers and acquisition.
MC: Management Committee

MIFID: Market in Financial Instrument Directive

MMF: Money Market Fund

MREL: Minimum Requirement for own funds and eligible liabilities. It refers to the percentage of eligible liabilities banks must hold to absorb losses in case of failure.

NBB: National Bank of Belgium

NID: notional interest deduction

NSFR: Net stable funding ratio

OFP: Organisations for Financing Pensions

REIT: Real estate investment trust

ROE: Return on equity

Search for yield: general concept which refers to behaviours of increased risk taking (in exchange for higher expected return) during periods with relatively low interest rates

Shadow banking: general concept which refers to financial entities providing similar financial services as traditional banks (financial intermediation).

SME: Small and medium sized enterprises

SPV: Special purpose vehicle

SRM: Single Resolution Mechanism – one of the 3 pillars of banking union

SSM: Single Supervisory Mechanism – one of the 3 pillars of banking union

Twin peak model: Supervisory architecture consisting of centralising macro- and micro prudential supervision within one institution (usually central bank), while consumer protection and market integrity is the responsibility of another institution (usually market authority).

WEF: World Economic Forum