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cutting through complexity

FINANCIAL SERVICES

The cumulative impact of regulation

An impact analysis
of the accumulation of regulations
on the Belgian banking sector

June 2013

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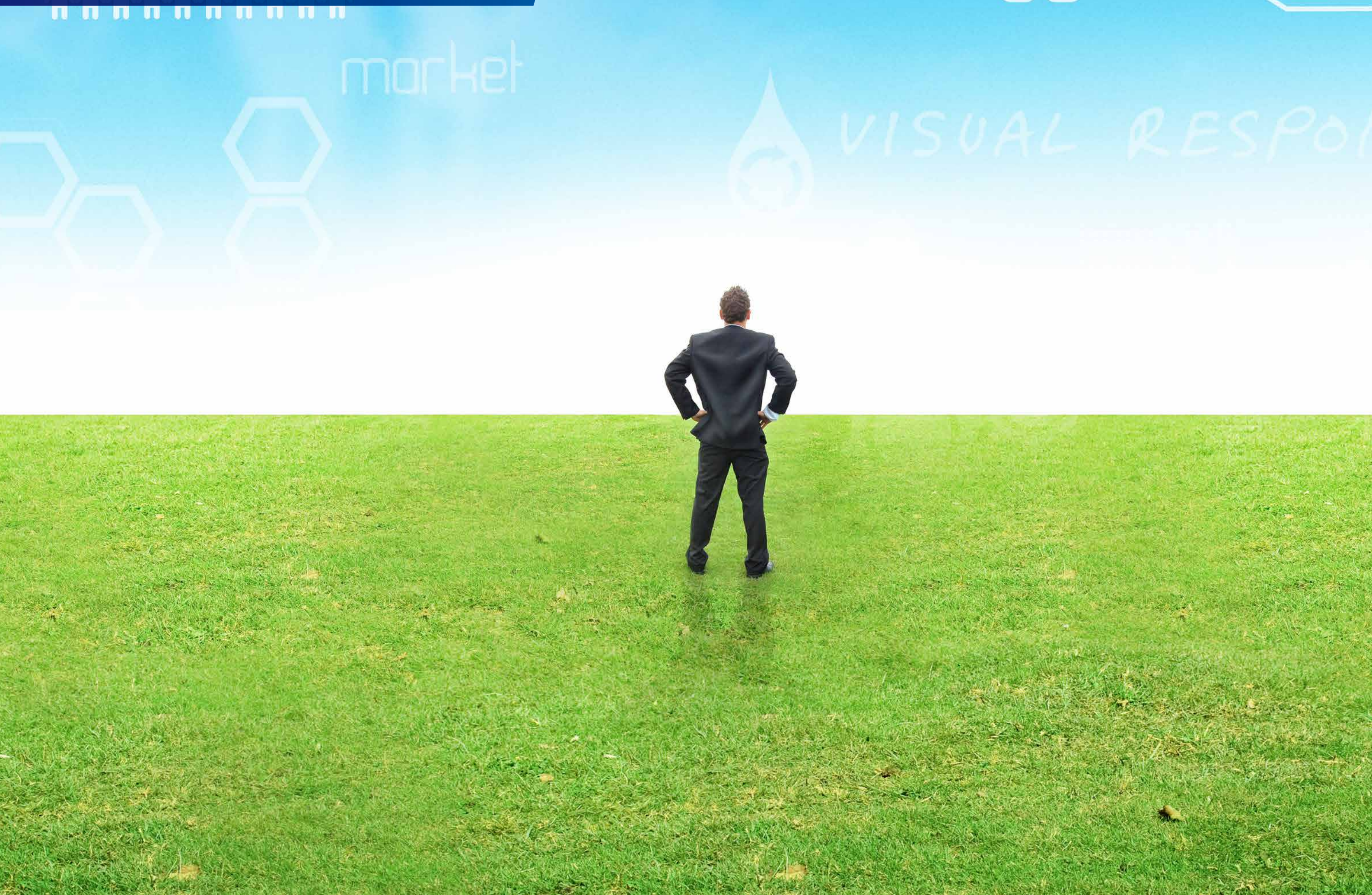


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1. Executive summary

In recent years, global, European and domestic legislators and authorities have introduced a large number of new regulations with the objective of making the banking sector more stable and reducing risks. Most sectoral studies focus on one stand-alone new regulation, which is analysed in much detail. By doing so, the bigger picture can be lost, bringing with it the risk of missing key inter-relationships and co-dependencies.

KPMG suggests that the financial sector, the politicians, the rules-setting bodies and banks' customers must all consider the combined and cumulative impact of all the new and proposed regulations. This study tries to provide insights on the magnitude of the cumulative effect of the most important new regulations on the banking sector in Belgium.

Core bank function

The core function of banks is to attract money from individuals and businesses and, in turn, re-inject this money in the economy by granting loans. By acting as counterparty between saver and borrower, several risks are transferred to the bank. The bank then assumes the risks of lending out the savings deposits and can mitigate them to a certain extent; for example: credit risks, by spreading them across different borrowers, and interest rate risks, by hedging them on the financial markets.

Through this core function, banks ensure the efficient use of available resources, which means that businesses and households earn interest on their savings and can take out credits.

The extent to which a bank fulfils this function determines the size and composition of its balance sheet. The risks arising from the bank's balance sheet (such as credit risk or interest rate risk) determine both the amount of capital (buffer) required to absorb unexpected losses as a result of these risks. In addition, banks are required to perform their core function while maintaining sufficient buffers (for solvency purposes), sufficient on-call funds (for liquidity purposes) and realizing returns that satisfy the requirements of their financers (providers of debt on the international capital markets and shareholders).

As such, by the nature of this core function, banks are facing the challenge of meeting the expectations of a diverse group of stakeholders, a demanding 'balancing act' (see Figure 1).

This challenge is rendered even more complicated by the fact that the various groups of stakeholders are not homogenous and voice their views in different ways. Despite all of these challenges, it is certainly in everybody's interest that the banking sector continues to offer secure, stable and reliable services.

Figure 1: Expectations of the major stakeholders

Private clients
- Mortgage lending
- Deposits at the best possible interest rate
- Security
- Secure payment transactions
- Innovation

Businesses
- Access to financing at the best possible interest rate
- Specialist advice
- Innovation

Regulators
- Solid banking institutions
- Customer protection
- Free and competitive markets

Government
- Tax payer protection
- Financing of economic activities

The general public
- No excessive returns
- No excessive bonuses

Equity providers
- Reasonable return on equity in line with risk profile
- Dividends
- Clarity about legal position
- Sufficient guarantee of getting their investment back

Employees
- Job security
- Competitive salary for specialists

Source: KPMG analysis

Regulation

As the Basel Committee for Banking Supervision states[1]:

> *"A strong and resilient banking system is the foundation for sustainable economic growth, as banks are at the centre of the credit intermediation process between savers and investors. Moreover, banks provide critical services to consumers, small and medium-sized enterprises, large corporate firms and governments who rely on them to conduct their daily business, both at a domestic and international level."*

Prudential regulation is designed to protect the banking system from crises because banking crises typically affect the entire economy. However, the latest financial crises (as from 2008) proved that the existing regulatory framework in which banks had to operate was not enough to prevent the need for taxpayer funds to bail them out. The understandable reaction from both politicians and regulators was a wave of regulatory reforms.

Most of the regulatory reform initiatives introduced since then, have been designed to make financial institutions safer. But the agenda is broader. Indeed, with its international partners in the Group of Twenty (G20), Europe has pursued a comprehensive programme of financial reform that will be implemented throughout the EU-countries. These reforms will not only make financial institutions safer, but will also stabilize the financial system and shift the cost of potential future failures from taxpayers to the creditors of failing institutions. As a result, the banking sector is facing a massive wave of new domestic and European regulations.

Figure 2: Overview of recent and pending regulations

Categories	Sub-category	No	Focus areas of regulations
1. Consumer issues	1.1. Payment services	1	Payment Services Directive (PSD)
		2	Electronic Money Directive (EMD)
	1.2. Retail Financial Services	3	Consumer Credit
		4	Mortgage credit
		5	Packaged Retail Investment Products (PRIPs)
2. Financial Institutions	2.1. Corporate governance and remuneration policies	6	Remuneration
		7	Governance
		8	Corporate governance and remuneration policies
	2.2. Banking	9	**CRD IV / Basel III**
		10	**DGS and bank contributions**
		11	**Crisis Management & Bank resolution (incl. bail-in)**
	2.3. Financial conglomerates	12	Financial Conglomerates Directive (FCD)
3. Financial Markets	3.1. FM Infrastructure	13	**European Market Infrastructure Regulation (EMIR)**
		14	Securities Law Directive (SLD)
		15	Central Securities Depositories Directive (CSDD)
	3.2. Securities	16	Market Abuse Directive & Regulation (MAD) II
		17	Rating Agencies
		18	Short selling
		19	Investor Compensation Scheme (ICS)
		20	**Markets in Financial Instruments Directive & Regulation (MiFID)**
		21	Transparency
	3.3 Investment Funds	22	UCITS / AIFMD
4. Cross-sector issues	4.1. Financial Crime	23	Money laundering and terrorist financing
	4.2. General Policy	24	Shadow Banking
		25	Banking Union
		26	Structural reform (ring-fencing)
		27	Supervision (BE)
		28	Supervision (US)
		29	**Financial Transaction Tax (FTT)**
		30	Foreign Account Tax Compliance Act (FATCA)
5. Other	5.1. Accounting	31	**International Financial Reporting Standards (IFRS)**

Source: European Commission, KPMG analysis

[1] Basel Committee for Banking Supervision: Basel III a Global regulatory framework for more resilient banks and banking systems (December 2010).

Figure 2 shows the 31 focus areas of new regulations that, in the aftermath of the financial crises, are (or will soon be) introduced in Belgium to cover consumer issues, financial institutions, financial markets, cross-sector issues and accounting. However it needs to be said that many of the reforms are still in the early stages of implementation, and some are still on the drawing board. Banks have to cope with this multitude of new global, regional and national rules and have to respond to a wide spectrum of new requirements, from capital and liquidity requirements to corporate governance, from derivatives to the design of retail products, and from resolution to remuneration. Undoubtedly the new regulations have a significant impact on the way in which banks can continue to fulfill their core function.

In order to obtain a sector wide-view of the impacts, KPMG conducted a study[2] in two steps. The first step consisted of a qualitative survey whereby participating banks were asked to provide their views on the effects of these 31 regulations. From this survey, KPMG identified the top seven regulations that are expected to have the biggest impact on the Belgian banking sector. The second step consisted of a quantitative analysis on the cumulative effect of the four rules expected to have the largest impact on the financial situation, and for which the impact is sufficiently quantifiable.

Qualitative analysis

In the qualitative survey (section 3), the different impact areas were analysed. On this basis, it was concluded that many regulations are not only a question of compliance but have significant impacts on the financial situation (balance sheet and income statement), on the business model, on the operating model and on the change capacity of banks. The regulatory reform agenda is perhaps the biggest driver of strategic and operational change – managing this is a key challenge for the entire industry.

The survey reveals that out of the 31 listed focus areas of new regulations the following seven pose the biggest challenges for the Belgian banking sector:

(1) CRD IV/Basel III

(2) International Financial Reporting Standards

(3) Crisis management & Bank resolution (bail-in)

(4) Financial Transaction Tax

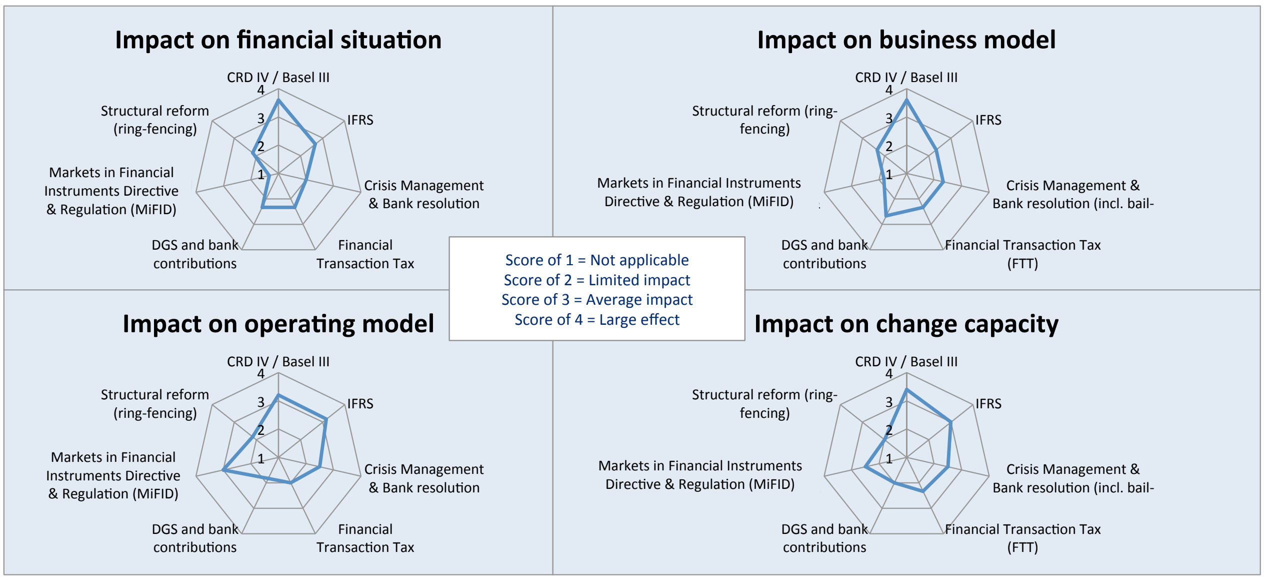
(5) DGS and Bank Contributions

(6) Markets in Financial Instruments Directive (MiFID)

(7) Structural reform (ring-fencing).

Figure 3 compares the scores obtained by the top seven regulations on a spider graph for each of the 4 evaluation axes.

Figure 3: Qualitative assessment for top seven regulations



[2] The study took place between January and April 2013.

Quantitative analysis

For the quantitative analysis (section 4), high-level data (balance-sheet, income statement and Basel III items[3]) have been collected from individual banks and then aggregated in order to produce a consolidated view. The sample of participating banks represents about 80% of the Belgian banking sector in terms of the size of the balance-sheet.

Only the direct impact was assessed for the period between 2013 and 2016 for a limited number of regulations under rather minimalistic assumptions[4], namely:

- CRD IV/Basel III
- Deposit Guarantee Scheme and other Bank Contributions (Stability contribution, "Loan-to-deposit" tax, "Abonnement" tax)
- Financial Transaction Tax
- Bail-in debt (crisis management framework)

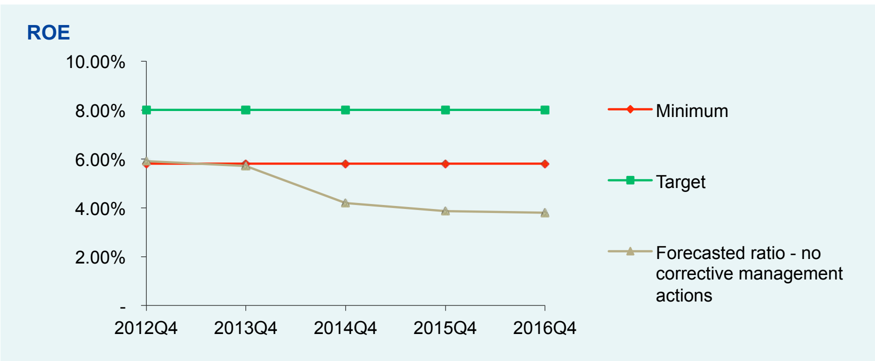
Figure 4 compares the projected level of the (Basel III) solvency, liquidity, and profitability ratios to the minimum regulatory requirements and target levels (market expectation) for end 2016.

Although the Belgian banking sector (ceteris paribus) does not fully reach the expected target levels with regard to solvency and liquidity, the imposed regulatory minimum ratios are not really in danger for the projected period. However the profitability ratio - return on equity - of the Belgian banking sector drops below 4% as from 2014 (see Figures 4 and 5).

Figure 4: Projected level of the Basel III and profitability ratios compared with minimum and target levels in 2016

	Projection 2016	Minimum 2016	Target 2016
Solvency ratio - Common Equity Tier 1 Ratio (CET1)	10.3%	7%[5]	11%
Solvency ratio - Leverage Ratio	3.9%	3%[6]	3.5%
Liquidity ratio – Net Stable Funding Ratio (NSFR)	113.6%	100%[7]	110%
Liquidity ratio – Liquidity Coverage Ratio (LCR)	106.6%	100%[8]	110%
Profitability ratio – Return on Equity (ROE)	3.8%	5.9%	8%
Profitability ratio - Cost/Income ratio	74.3%	N/A	65%

Figure 5: Evolution of Return on Equity for Belgian banking sector over the horizon 2013-2016



[3] Basel III items are retrieved from the official banks' Basel III monitoring sheets that are submitted to the National Bank of Belgium.
[4] For example: FTT (EUR 1 billion), bail-in (28 basis points on 33% of total liabilities). However, we took note of recent comments in the press that impact of FTT could be softened quite drastically.
[5] Includes capital conservation buffer, level applicable in2019
[6] Applicable during the parallel run period
[7] Not yet confirmed, KPMG estimation
[8] Level applicable in 2019

This leaves the Belgian banking sector with no other choice than to take corrective measures to restore profitability while keeping solvency and liquidity at acceptable levels.

Each bank will of course determine the measures that it deems best suited to address its own challenges, in a competitive environment. That being said, the political world, rules-setting bodies and bank customers should understand that there are only a limited number of measures that banks can adopt. KPMG believes that – assuming that banks aim at reaching the solvency, liquidity and profitability target ratios mentioned above by 2016 – the following mix of actions is a plausible one:

- A structural net cost reduction of 10% achieved in year 1;
- Extra non-interest income (fee business) generated at a rate of 2.5% per year;
- Re-pricing of "debts to clients" by 25 basis points (assuming 30% of the portfolio is re-priced each year);
- Re-pricing of loans by 70 basis points (assuming 10% of the portfolio is re-priced each year); and
- A "liquidity transformation of assets"[9] for an amount of EUR 5.5 billion applied in 2013.

Needless to say that other scenarios or mixes of actions are possible. Nevertheless KPMG's analysis shows that it will be almost impossible to comply with the requirements by concentrating on only one measure. For instance, if only cost-reduction is considered as a possible measure, a structural cost reduction of 40% would be needed with undoubtedly undesired repercussions on employment. On the other hand if the additional regulatory costs were fully transferred to the clients (borrowers), a re-pricing of loans by 230 basis points (10% of the portfolio is re-priced each year) would be needed to reach the targets.

Such "narrow" measures are, in KPMG's view, less probable because they seem hardly sustainable and would have irremediable consequences for all stakeholders. The more realistic combined scenario highlights the fact that new regulations that reduce risks and have a positive effect on the stability of the banking sector have adverse effects on profitability and access to capital. Consequently, it would come at the cost of stimulating the economy. At the same time, more stability contributes towards a fertile business climate and increased public confidence in the industry.

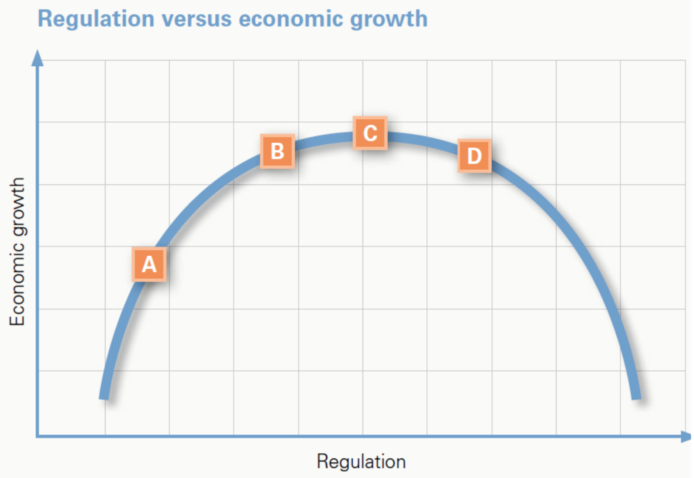
As an illustration of this dissension, Figure 6 (on the following page) shows the cost/benefit relationship of additional regulation. It shows that there is an indexation-point beyond which the negative impact of regulation on economic growth in normal times begins to exceed the benefits of regulation.

[9] This measure consists of adapting the nature of the investment portfolio and is modeled by a yearly transfer of a certain amount from non-liquid assets to liquid assets. It is further assumed that this transfer generates an opportunity cost (~2%) on the investment portfolio as liquid assets are expected to generate lower returns.

Figure 6: Cost versus benefits of regulatory reforms

The relationship between regulation and economic growth may be illustrated by a simple chart, plotting these two variables. Up to a point, regulation promotes economic growth, not least because the negative impact of regulation on economic growth in normal times is more than offset by avoiding the severe costs of financial crises. But there is an inflexion point beyond which the negative impact of regulation on economic growth in normal times begins to exceed the benefits of regulation.

The really difficult question is establishing where the 'tipping point' lies. There is general agreement that before the financial crisis we were at point A, where too little regulation contributed to the costs of financial crises on economic growth. Official estimates of the Basel 3 capital and liquidity reforms moved regulation up to point B, leaving scope for additional regulatory reforms before reaching the 'optimal' point C. However, the evidence in Europe in particular suggests that we have moved beyond point C to point D, where excessive regulation is so damaging to the wider economy that the net impact of regulation on economic growth has become negative.



Source: KPMG, May 2013

Based on the input from participating banks, KPMG expects that – on average – the following issues/attention points can be expected in the short-term:

- Higher liquidity and solvency levels will lower the risk profile of banking operations (which is positive). But it still remains to be seen whether investors will be willing to invest at lower returns against a backdrop of numerous alternative investment opportunities, and whether banks will be able to maintain the capital buffer requirements.
- There is pressure for banks to reduce costs further with possible negative consequences for employment in the sector.
- Given traditional market dynamics, banks might attempt to partly transfer the cost of regulation towards customers of the bank under the form of more expensive (or less available) financing and less remunerated deposits.
- The bail-in debt rules means that debt funding providers will be confronted with a higher risk of debt being written down or converted into equity in case of bank resolution. This results in a higher return requirement from the provider which could reduce banks' access to the capital market.
- Basel III/CRD IV stimulates investments in government bonds, and this type of investment strengthens the ties between the state's finances and credit rating and those of the bank.
- Given the large cumulative impact of the regulations, it should be stressed that regulations not only have a direct financial impact, but also a significant influence on banks' capacity for change. With a large number of regulation-driven projects in the banking sector – certainly true in the current economic climate – it is a challenge to free up a sufficient number of the highly skilled resources and capital needed to carry out initiatives aimed at realising objectives focused on consumer satisfaction, innovation and commercial performance.
- An important evolution that cannot be neglected is the development of "shadow banking" in Europe. The economic reality is that banks are deleveraging and, as result, the provision of credit and liquidity is increasingly coming from non-banking firms. These institutions are not subject to the same prudential supervision. However, a question that remains is how regulated banks will manage to compete with these less regulated non-banks operating in the market.

In conclusion, the different stakeholders in the debate (political, financial, customers and supervisors) should take proper account of the cumulative impact of the multiple reform initiatives and of the uncertainty surrounding the many unresolved items on the regulatory agenda. Stakeholders must be conscious that additional regulation is not a "free good".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2. Approach and structure of the report

KPMG analysed the effects of the accumulation of regulations on the Belgian banking sector[10]. The cumulative impact analysis was conducted based on data and input, as delivered by participating members of Febelfin. The scenarios with corrective action for reaching the target levels of solvency, liquidity and profitability were developed by KPMG to provide more insight for the policy-makers, the banking customers and all other stakeholders in how the banking sector might evolve and what economic consequences this might bring. Since this part of the report is forward looking, it is inherently based on a number of assumptions in terms of targets, periods to reach those targets and measures that will be deployed to reach them. These assumptions are working hypotheses of KPMG; they do not necessarily correspond to actual choices that will be made by individual banks. The goal in making these assumptions, is to make a reasonable estimate of the efforts needed to neutralize the cost impact of new regulations.

As a first step, a total of 31 new rules and initiatives (hereafter called "rules" or "regulations") were analyzed. They were grouped into five categories as illustrated below.

Figure 7: Number of rules analyzed per category

Categories	Number of rules
1. Consumer issues	5
2. Financial Institutions	7
3. Financial Markets	10
4. Cross-sector issues	8
5. Other	1
Total	31

In section 3 of this report, a general overview of these rules is provided[11] and the results of the qualitative survey are presented. These results reflect the views of the participating banks on the impacts of the above mentioned rules centered around four axes: a) effect on bank's financial situation (balance-sheet and income statements), b) effect on the business model of the bank, c) effect on the operating model, and d) effect on the change capacity. The qualitative assessment consisted of scoring the listed rules between 1 (not applicable) and 4 (large effect) for each of the 4 axes.

In section 4, a quantification is performed of the cumulative effect of the four rules expected to have the largest impact on the financial situation and of which the impact is sufficiently quantifiable[12], namely:

- Basel III/CRD IV: these concern measures to increase the stability of banks. The main purpose of these measures is to improve the quality and quantity of the capital that banks are required to hold, to increase liquidity buffers, and to significantly strengthen risk management;
- Deposit Guarantee Scheme (DGS) and other bank contributions. Under the Deposit Guarantee Scheme a fund is established to which banks can contribute on a yearly basis[13]. The purpose of the fund is to pay out to holders of savings accounts and current accounts (up to EUR 100.000) in the event that a bank can no longer meet its obligations. The other bank contributions taken into account are specific Belgian taxes to be paid by banks: financial stability contribution, loan-to-deposit tax and "abonnement tax";
- Bail-in debt (crisis management framework): a measure that grants regulators the power to convert certain types of debt into equity upon the occurrence of a 'trigger event' (when a bank gets into difficulty). This means that some of the bank's debt holders (financers) have to share the burden of any losses incurred by the bank;
- Financial Transaction Tax (FTT): a new tax to be imposed on a wide range of financial instruments, from capital markets instruments, money market instruments (including repurchase agreements and reverse repurchase agreements), derivatives to undertakings for collective investment in transferable securities (UCITS) and alternative investment funds. Practical implementation of this measure is still under discussion.

[10] The study took place between January 2013 and April 2013.
[11] A short summary of their scope and effects is given in Appendix A.
[12] Only the direct impacts of the selected rules have been taken into account.
[13] The contribution to the fund is estimated at ~ EUR 0.84 billion for the Belgian banking sector in 2012.

The quantitative analysis covers the prospective period 2013-2016 because the peak of the implementation of new measures in the banking sector will be during the next four years. It is important to note here that, for determining the effects, it is not always possible to assume the formal implementation periods which, in some cases, run until 2019. However market discipline encourages banks to implement certain requirements earlier, as in the case of the capital requirements of Basel III, rather than on the official implementation date as the rule requires.

In determining the quantitative impact of the measures on the Belgian banking sector as a whole, the initial situation, adjusted for the most important Basel III effects (post-migration), was first established. This was done based on the Q2 2012 data received from the participating banks[14], ensuring 80% coverage of the Belgian banking sector in terms of the balance-sheet. The effects of the above regulations (DGS and bank contributions, bail-in and FTT) were then extrapolated to provide insight into the solvency, liquidity and profitability of the banks – on average – had they not implemented any possible measures. It is important to note that, as some regulations are still in a consultation phase (bail-in and FTT), some assumptions had to be made which influenced the results of our analysis.

Based partly on literature studies and workshops with banking experts, possible measures that banks could implement (management actions) are assumed in order to comply with regulation and uphold profitability. These measures were chosen by KPMG out of the following list of alternative actions. Needless to say, other measures could be possible as well.

- Cut costs;
- Issue new capital;
- Generate extra non-interest income (primarily fee business);
- Re-price credit (increase interest on loans);
- Re-price attracted funding (decrease interest paid on deposits);
- Transfer from less stable deposits to more stable ones;
- Change the nature of the investment portfolio[15];
- Retain earnings instead of paying dividend.

KPMG then analysed different combinations of measures that result in reaching the established target levels of solvency, liquidity and profitability.

The method applied and the information available for the survey inherently have a number of limitations, such as the subjectivity of assumptions and the representativeness of the Q2 2012 figures (submitted by the participants to the survey) as the basis for assessing developments in the coming years.

Moreover, economic developments, for instance increasing credit losses, interest rate expectations and demand/supply interactions are not taken into consideration. The estimated effects of Basel III, DGS and the bank taxes can already be calculated on the basis of a clear set of requirements. However, bail-in debt (as a component of the crisis-management package) and the Financial Transaction Tax, are relatively new concepts and still have to be incorporated into Belgian regulations. However, assuming that the FTT will be voted on soon, it is already clear that these measures will lead to an increase in (funding) costs for banks in the coming years. This increase in costs means that the calculated results must be seen as a substantiated and consistently calculated assessment that will nevertheless to some extent remain shrouded in uncertainties.

[14] Figures provided by the participating banks have been considered as trusted information; no additional review has been performed by KPMG.

[15] This measure consists of adapting the nature of the investment portfolio and is modelled by a yearly transfer of a certain amount from less-liquid to more-liquid assets. It is further assumed that this transfer generates an opportunity cost (~2%) on the investment portfolio as liquid assets are expected to generate lower returns.

It can also be noted that the results of the quantitative analysis underestimate the real cumulative impact of new regulations as only the direct impacts of the selected rules have been taken into account and many other rules (e.g. IFRS, MIFID, structural reform, etc.) have not been included in the quantitative study but also have important direct and indirect impacts on banks' financial situation, business model, operating model and change capacity.


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3. The qualitative effects of regulations on banks

3.1 Financial sector reform and new regulations

EU response to the financial crisis

Following the outbreak of the financial crisis in 2008, the stabilization of financial markets became a priority and financial sector reform a crucial instrument to achieve it .

Over the last five years, Europe has played a key role in shaping a global response to the crisis strengthening regulation and supervision of the financial sector (see Figure 8). With its international partners in the Group of Twenty (G20), Europe has pursued a comprehensive programme of financial reform that will be implemented throughout the EU-countries. As a consequence of this reform, the banking sector is facing a massive wave of new domestic and European regulation

Figure 9 (on the following page) gives a general overview of recent and pending regulations at European and Belgian levels, grouped into five distinct categories based on their focus areas:

Consumer issues
This category groups the regulations that refer to payment services and those that refer to retail financial services. Initiatives in these focus areas aim at increasing consumer protection and transparency.

Financial institutions
This category groups regulations that focus on: improvement of the corporate governance of financial institutions and strengthening of the stability of the sector.

Financial markets

Under this category, are the regulations that promote more stability, transparency and efficiency in financial markets and increase protection of investors.

Cross-sector issues

This category groups regulations that go beyond the scope of the financial sector.

Other
For this analysis this category only covers changes in accounting standards for financial instruments.

Figure 8 : EU's framework for supervision

Source: FIN-FSA

16 European Commission, The EU Single Market, http://ec.europa.eu/internal_market/finances/index_en.htm
17 European Commission, A new financial system for Europe – Financial reform at the service of growth, http://ec.europa.eu/internal_market/publications/docs/financial-reform-for-growth_en.pdf
18 A short summary of their scope and effects is given in Appendix A.

Figure 9: Overview of recent and pending regulations

Categories	Sub-category	No	Focus areas of regulations
1. Consumer issues	1.1. Payment services	1	Payment Services Directive (PSD)
		2	Electronic Money Directive (EMD)
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		17	Rating Agencies
		18	Short selling
		19	Investor Compensation Scheme (ICS)
		20	**Markets in Financial Instruments Directive & Regulation (MiFID)**
		21	Transparency
	3.3 Investment Funds	22	UCITS / AIFMD
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	4.2. General Policy	24	Shadow Banking
		25	Banking Union
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		27	Supervision (BE)
		28	Supervision (US)
		29	**Financial Transaction Tax (FTT)**
		30	Foreign Account Tax Compliance Act (FATCA)
5. Other	5.1. Accounting	31	**International Financial Reporting Standards (IFRS)**

Source: European Commission, KPMG analysis

3.2 Method

The magnitude of the challenges banks are facing as a consequence of the regulatory reforms is significant. The sector does not only need to become compliant with a complex set of new regulations within a short timeframe. It needs to do it in a challenging environment (i.e. low growth outlook, increased non-performing loans, etc.) where customers want lower banking costs, bank's creditors want to make sure they get their money back and shareholders want them to be profitable again.

It is clear that the impact of all these new regulations will be reflected in banks' financial situation, in their business model and in their operating model. The large number of regulations faced by the banking sector also has an impact on a bank's capacity for change.

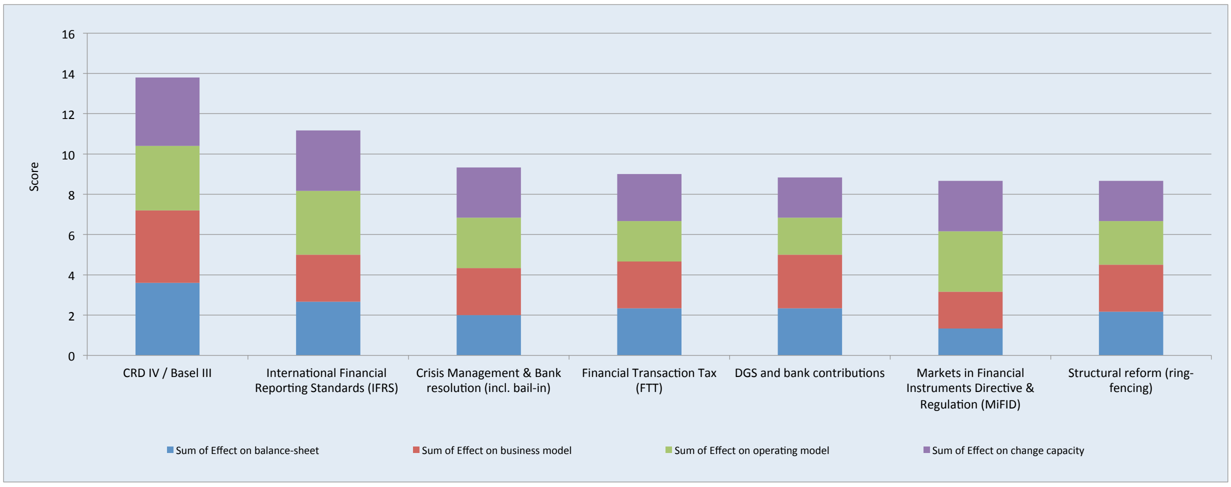
In order to obtain a sector wide view of the impacts of these regulations, KPMG conducted a qualitative assessment using a survey. KPMG listed new (since 2008) and expected EU & Belgian regulations considered relevant for Belgian banks and asked the banks participating in the survey to perform a qualitative assessment by (individually and anonymously) scoring regulations between 1 (regulations are not applicable or have a very limited impact) and 4 (regulations have a large effect) along the four axes: financial situation, business model, operating model and change capacity. For the purposes of this survey these are defined as follows:

- Effects of regulations on the financial situation of a bank: rules that have a direct impact on the bank's balance-sheet (particularly in terms of the liabilities and equity) or income statement.

- Effects of regulations on a bank's business model: rules that have a direct impact on the model implemented to generate revenue and to make a profit from operations. Such a model includes the components and functions of the business, as well as the revenues it generates and the expenses it incurs. Obviously interest income, cost of funding, and other revenues (such as commission income) play a decisive role in determining the business model.
- Effects of regulations on a bank's operating model: regulations have different degrees of impact on the effectiveness and efficiency of the operating model and, as such, on the costs, for banks. For the purposes of this qualitative analysis, the operating model is deemed to be: the organization and processes, as well as the IT infrastructure, which is required for a bank to function.
- Effects of regulations on a bank's change capacity: implementation of the new regulations will divert management's attention from initiating and implementing internal changes or exploring other businesses. The accumulation of regulations puts additional pressure on already scarce resources, as generally the vast majority of the efforts are concentrated on a very limited number of key people.

Figure 10 shows the top seven regulations that scored highest, according to the participants. The total scores are compared on a scale up to 16, which corresponds to the maximum score a regulation could obtain if all participating banks rated the regulation with a score of four along the four axes.

Figure 10 : Top seven regulations with the biggest impacts



3.3 Effects of regulations on banks

In this section, we will describe the most important impacts of the top seven regulations referred to in section 3.2. Appendix B provides the overview of results on all of the 31 new regulations.

Figure 11 compares the scores obtained by the top seven regulations on a spider graph for each of the four evaluation axes.

3.3.1 CRD IV/Basel III (see also appendix A – focus area 9)

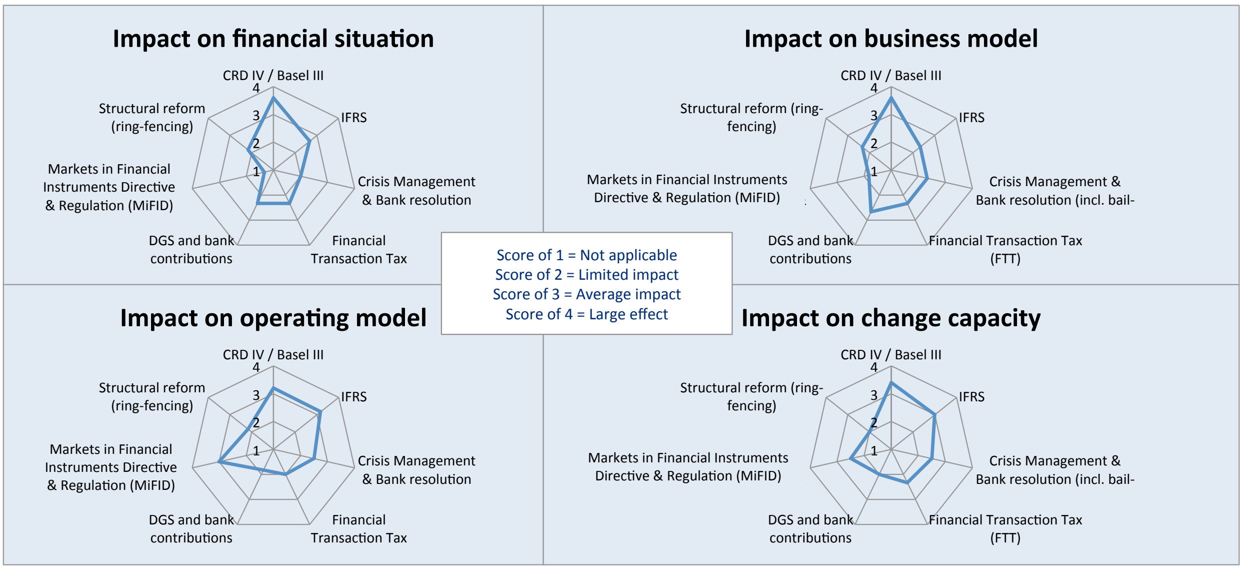
In the EU, Basel III is transposed in legislation through the CRD IV package, which includes the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (to be implemented through national law). The European Parliament, Council and Commission only just agreed on the CRR and CRD, a draft of which was first proposed by the Commission in July 2011. Significant changes were made to the CRR and CRD during this "trialogue" process[19].

EU implementation can therefore commence on 1 January 2014, provided the legislation is published in the European Official Journal before the end of June 2013. The timelines in the CRR and CRD mean that the EU will meet the Basel III timetable for full implementation by 2019.

The new legislation consists of two instruments that govern the requirements for investment firms and credit institutions, including banks.

- As a Regulation, the CRR will apply directly in every member state. It imposes a single set of rules across the EU, leaving some scope for national discretion. The CRR replicates in large part the Basel III capital and liquidity package, with the addition of some national flexibility in the use of macro-prudential instruments.
- As a Directive, the CRD will have to be incorporated into the national laws of member states. It covers the basis on which firms can pursue banking and investment business; the freedom of establishment and the free movement of services; supervisory processes, powers and sanctions; corporate governance and remuneration; and capital buffers (including for systemically important firms).

Figure 11 : Qualitative assessment for top seven regulations



[19] Negotiation process between the European Commission, the European Council and the Parliament

Capital requirements

Under Basel III, total regulatory capital is the sum of Tier 1 Capital, consisting of Common Equity Tier 1 and Additional Tier 1, and Tier 2 Capital (gone-concern capital). A key element of the new definition of capital is a greater focus on common equity, which is the highest quality component of a bank's capital:

- Common Equity Tier 1 (CET1) must make up at least 4.5% of risk-weighted assets (in 2015);
- Tier 1 Capital must make up at least 6.0% of risk-weighted assets (in 2015);
- Total Capital (Tier 1 Capital plus Tier 2 Capital) must make up at least 8.0% of risk-weighted assets.

In addition to this, a capital conservation buffer of 2.5%, comprised of Common Equity Tier 1, is established above the regulatory minimum capital requirement, bringing the minimum amount of CET1 to 7% (in 2019) compared to 2% under Basel II.

Leverage ratio

A key ingredient in the market disruption during the financial crisis was inadequate capital protection. The pre-crisis capital framework, which relied heavily on risk-weighted assets (RWAs), had several drawbacks. The complexity of the Basel RWA methodology provided for example banks with the opportunity to manage RWAs to reduce capital requirements. In doing so, banks could concentrate their balance sheets in certain asset classes that, in aggregate, could expose the institution to more risk than the lower risk weightings would imply.

With the proposed new capital framework, the Basel Committee is introducing a leverage ratio requirement that is intended to achieve a more constrained leverage in the banking sector and inserting additional safeguards against model risk and measurement error. The leverage ratio will force banks to account for all assets, even those assets assigned low risks weights in the Basel systems.

The Committee will test a minimum Tier 1 leverage ratio of 3% during the parallel run period which lasts until January 2017:

(Tier 1 Capital)/(total on- and off-balance sheet exposure)>3%

Liquidity ratios

Basel III proposes two key liquidity-related ratios.

The Liquidity Coverage Ratio (LCR) is designed to strengthen the ability of banks to withstand adverse shocks. It requires banks to hold sufficient high-quality liquid assets (HQLA) including cash, government bonds and other liquid securities to meet the needs for a severe cash outflow of at least 30 days.

(The value of the stock of HQLA)/(total net cash outflows over the next 30 calendar days)>100%

The second key ratio, the Net Stable Funding Ratio (NSFR), is intended to ensure better matching between assets and liabilities. Banks are required to hold sufficient stable funding such as capital, long-term debt instruments, retail deposits and wholesale funding with a maturity longer than one year to match their medium- and long-term lending activities.

(Available Stable Funding)/(Required Stable Funding)>100%

Figure 12 : Basel III phase-in arrangements

	Phases	2013	2014	2015	2016	2017	2018	2019
Capital	Leverage Ratio	Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015					Migration to Pillar 1	
	Minimum Common Equity Capital Ratio	3.5%	4.0%	4.5%				**4.5%**
	Capital Conservation Buffer				0.625%	1.25%	1.875%	**2.5%**
	Minimum common equity plus capital conservation buffer	3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	**7.0%**
	Phase-in of deductions from CET1*		20%	40%	60%	80%	100%	**100%**
	Minimum Tier 1 Capital	4.5%	5.5%	6.0%				**6.0%**
	Minimum Total Capital	8.0%						**8.0%**
	Minimum Total Capital plus conservation buffer		8.0%		8.625%	9.25%	9.875%	**10.5%**
	Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital	Phased out over 10 year horizon beginning 2013						
Liquidity	Liquidity coverage ratio – minimum requirement			60%	70%	80%	90%	**100%**
	Net stable funding ratio						Introduce minimum standard	

* Including amounts exceeding the limit for deferred tax assets (DTAs), mortgage servicing rights (MSRs) and financials.
– – transition periods

Source: Basel Committee on Banking Supervision (BCBS), Bank for International Settlements (BIS)

Impacts

Banks are already monitoring closely where they stand against the Basel III minimum capital, leverage and liquidity ratios. For some banks the remaining scale of adjustment for pure compliance seems to be rather limited. However, although a phased-in timeline has been agreed to by the BCBS (see Figure 12 for Basel III phase-in arrangements), in some markets there is a trend, spurred by regulators and market analysts, to set ambitious compliance deadlines and more ambitious target ratio levels. According to KPMG's analysis, banks might assume that early implementation and overshooting of the minimum ratios could contribute to their competitive advantage, and be a way of demonstrating their soundness. Other organizations might be aware of the reputational and regulatory risks of being perceived as trailing behind in the race to meet compliance regulations - and respond accordingly

Financial situation

Much of the focus is on the impact on profitability. With common equity requirements more than tripling[20] (estimates of eligible capital are reduced by as much as 60%, and estimates of risk weighted assets (RWA) are increased by up to 200% or more depending on a firm's circumstances) it seems likely that there will be an effect on the return on equity (ROE). The level of this impact will depend on the individual operating models[21].

Meeting the liquidity target ratios will remain – according to KPMG – a major challenge for the banks and even after the recent relaxing of LCR requirements, many banks will need to make expensive changes to their balance sheets:

- Increased demand for the highest quality liquid assets will reduce the return on these assets, adding to the downward pressures on banks' profitability especially in a period of structurally low interest rates.
- Long term wholesale deposits will be significantly more expensive and more

[20] Minimum amount of CET1 (including capital conservation buffer) of 7% (in 2019) compared to 2% under Basel II.
[21] Basel III: pressure is building, KPMG, December 2010

difficult to obtain, especially for smaller banks (in a very competitive market).

- Retail deposits will become less stable as greater competition for retail deposits drives an increased reliance of banks on rate-sensitive and internet funding, and as switching between banks becomes cheaper.

As a result, there is a shift in balance sheet planning from an asset-based approach to a liability driven approach, reducing the probability of significant balance sheet expansion.

Business model

Yet, the proposed rules will go far deeper than a simple impact on profitability and ROE. The requirements might carry a fundamental impact on business models and the shape of the business conducted by banks. Some types of business (particularly in the trading book) see significant increases in RWAs and therefore in capital.

Operating model

There are also many impacts on the operating model.

- Meeting the requirements places enormous strains on banks' data and systems which may in many cases be inadequate for the task.
- Liquidity contingency planning, stress tests, new liquidity key risk indicators and transfer pricing for larger banks need to be put in place and embedded in the day to day business.
- Increased supervisory focus on local capitalisation and local funding, matched with the Basel III treatment of minority investments and investments in financial institutions is likely to drive group reorganisations, including M&A and disposals of portfolios, entities or parts of entities where possible.

The above shows that Basel III/CRD IV poses multi-dimensional issues, impacting strategy, methodologies, organizational structures, processes, IT... making it the most impactful regulation within the qualitative ranking of new regulations.

3.3.2 IFRS (see also appendix A – focus area 31)

In September 2009, the G20 Pittsburgh summit called on the international accounting bodies to "redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011". Although since then the deadlines were postponed several times, the IASB and FASB are accelerating the development of a number of projects, including accounting for financial instruments. Numerous changes to existing accounting standards are in the pipeline, in various stages of completion with varying degrees of harmonization.

The IASB already issued *IFRS 9 (International Financial Reporting Standard) on classification and measurement of Financial Instruments* and the *IFRS 13 on Fair Valuation*. These will change the way that financial assets and liabilities are classified and measured. Several recent amendments to *IFRS 7 Financial Instruments Disclosures* require additional disclosures of information about financial instruments, both in qualitative and quantitative terms.

On 7 March 2013, the IASB issued its long-awaited revised proposals on accounting for the impairment of financial assets. The proposals aim to address concerns about the "too little, too late" provisions for loan losses and would accelerate recognition of losses by requiring provisions to cover both already-incurred losses and losses expected in the future. New proposals on hedge accounting are also foreseen.

Impacts

While there remain a significant number of unresolved issues, it can be assumed that banks cannot afford to wait to see how all these dynamics play out. The changes necessary to meet the requirements for policies, business models, data architecture, and education on new rules are time consuming and complex.

It is not surprising that most of the impact is expected to be on the financial situation and operating model.

Financial situation

Measuring assets at amortised cost generally leads to less volatility in P&L and/or Other

Comprehensive Income (OCI) than measuring assets at fair value. The implementation of IFRS 9 will reduce the volatility of the accounting measurement of some assets while other assets will have to be measured at fair value, which will probably increase the measurement volatility.

Operating model

A critical step towards IFRS 9 is a close analysis and monitoring of those key attributes of financial assets that impose high requirements on availability and quality of data.

The IASB proposals introduce a new "expected loss" impairment methodology. Most banks are likely to see a significant impact and may need additional systems and processes to collect the necessary information.

Business model

A pattern of linking accounting to an entity's business model and risk management processes is emerging from the new IFRS 9. This approach seeks for accounting to reflect the economics of entities' business models and how these entities manage their business. The distinction between the two measurement models, fair value and amortised costs, is in fact mainly driven by the different business models of the bank. Undoubtedly this also means that banks revisit their current business models and eventually bring them in line with the desired IFRS accounting treatment.

Under Basel III, Common Equity Tier 1 would include the full amount of changes in the fair values of financial assets recognized in OCI (with a phasing-in approach). As a result, the move to IFRS 9 may require careful analysis of the potential impacts on banks regulatory capital as it depends on how financial assets are classified and measured under the IFRS 9.

It is also worth mentioning that the interaction between changes to the regulatory (see above: Basel III / CRD IV) and accounting requirements, means additional complexity and that the two projects will require co-ordination. This also explains the reason why these two new regulations are expected to have the biggest impact on the change capacity of the Belgian banking sector (see Figure 11)

3.3.3 Crisis management and Bank resolution (including bail-in tool) (see also appendix A – focus area 11)

In the EU, the proposed Recovery and Resolution Directive (RRD) represents a massive step forward for the resolution of banks – but this can only be achieved once the Directive is finalised and implemented by each member state. The draft RRD has already acted as a 'wake-up call' to banks in many European countries who had previously made only limited progress on resolution planning. The EBA's recent announcement requiring plans from Europe's 39 largest cross-border banks before the final RRD, will accelerate the efforts needed.

However, it was noticed that in Europe national authorities may take different approaches regarding the areas (such as the stresses and scenarios) that a recovery plan should cover; the extent to which national authorities require banks to make their recovery plans more robust; the detailed information to be provided within resolution packs; the financial and economic functions considered critical; the extent to which national authorities require banks to change their business activities and their legal and operational structures in advance, to reduce the cost and complexity of the resolution; and the use of resolution tools and powers by national authorities.

The Financial Stability Board (FSB) has therefore undertaken and published a detailed review of resolution regimes – across the 23 members of the FSB and across different financial sectors. Not surprisingly, these countries still have a long way to go in implementing resolution regimes that meet all aspects of the FSB's "key attributes" of resolution regimes. Major shortcomings include the absence of powers to bail-in the creditors of a bank and the lack of arrangements to implement the resolution of cross-border groups.

In Belgium, until now local banks have only been required to provide recovery plans to the national supervisor. As such Belgian banks face a period of continuing uncertainty before the RRD and the resolution powers of the authorities are finalized – and it will probably be even longer before effective cross-border resolution measures are introduced.

In any case, it can be expected that the implementation of the requirements will generate major challenges for banks, in terms of both their legal and operational structures and the costs of recovery planning and bail-in liabilities. Of course the recovery and resolution options that may be available to banks vary considerably and it is recognized that there could be trade-offs between the benefit of possible actions in terms of assisting recovery and resolution objectives and their associated costs.

Impacts

Financial situation & Business model

Banks will need to hold the amounts and types of "bail-inable" liabilities required by national authorities. Such liabilities are likely to be expensive for banks, because unsecured and uninsured creditors will demand a higher return to reflect the removal of implicit state support.

In addition, banks will have to make the changes required by the authorities to improve the credibility and effectiveness of recovery and resolution planning, including higher amounts of contingent capital and funding to underpin recovery, and changes to business activities, legal entities and operational structures to facilitate an effective resolution.

Operating model

Banks are deciding whether part of their plan should include a bold structural shift in their operating models (e.g. ring fencing (section 3.3.7), changes to legal structure or sale of core businesses) or whether they should instead follow a path of incremental change (by selling non-core assets and deleveraging), to adapt their existing model incrementally until the structural shift becomes imperative.

Change capacity

Time needs to be spent on developing recovery plans based on severe stresses and scenarios, with prospective actions linked to specific triggers and on developing resolution packs to enable national authorities to take a position as to whether effective and credible resolution plans can be constructed – banks will have to provide extensive information to their national resolution authorities.

3.3.4 Financial Transaction Tax (see also appendix A – focus area 29)

In February 2013, The European Commission published its proposals for a financial transaction tax (FTT). The proposals would introduce a tax on transactions in certain financial instruments undertaken by financial institutions such as banks, investment firms, insurance entities, etc in the FTT zone[22], which includes Belgium. Generally the FTT would be applied at a rate of 0.01% of the nominal value of derivatives and 0.1% of the market value of securities. However the actual amount of tax payable will be much higher if several intermediaries are involved e.g. a broker. FTT is not another tax compliance exercise. It will affect business models, transaction pricing, trading decisions and most importantly the returns to end users such as pension funds, mutual funds and life insurance companies. Stakeholders are now analysing the potential impacts of an FTT, which all indicate significant negative impacts, such as increasing the cost of capital, decreasing trading volumes and liquidity, and decreasing total returns for investors - both for the FTT zone and globally. Despite these impacts, there seems to be little doubt that the FTT will be implemented in some form. But it remains unlikely that the FTT will be fully in place by 1 January 2014.

Impacts

Financial situation

Banks will need to identify the affected instruments and review them to assess implications for strategy and pricing – for example, will institutions outside the FTT zone avoid (or seek to synthesize) FTT zone issued securities?

It is foreseen that financial positions subject to FTT which are technically short-term but continually rolled over as part of a longer term position in practice, will attract FTT every time the trade is renewed – which will significantly increase the overall cost and could shake-up the common market practice.

According to different studies, under the current proposals, profitability of the Belgian banking sector is expected to be hit quite significantly.

[22] Eleven member states agreed to proceed under the EU's "enhanced cooperation" procedures: Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, and Spain

Business model

It is expected that some lines or businesses may become uneconomic and others will need to be restructured (e.g. by reducing the number of parties/steps involved in a trade or acting as an agent rather than as a principal).

Moreover, trading volumes (and therefore liquidity and the bid/offer spread) in FTT zone-issued securities are likely to be adversely affected.

Operating model

Significant systems challenges are anticipated. Systems should be reviewed to assess the changes needed to flag counterparties or instruments subject to FTT. Also, models must be updated to reflect FTT implications in pricing and valuation. In addition, processes and IT should be reviewed to assess the necessary change to identify, record, collect and pay FTT incurred.

Change capacity

The Commission has proposed a start date of 1 January 2014 for implementation of FTT. This gives financial institutions a very short window to assess the impact on business models and pricing and develop systems to account for and pay the tax. The challenge this implies is significant and while the current proposals may be refined by member states, some businesses have started preparing now while others adopt a "wait-and-see" attitude as they believe that the FTT will be significantly downplayed as a result of the collateral impact.

3.3.5 DGS and Bank Contributions (see also appendix A – focus area 10)

The impact of the Deposit Guarantee Scheme and other new bank contributions (Resolution Fund, Loan-to-deposit tax, "Abonnement" tax) is obviously more important for the financial situation than on the business or operating model. We refer to the quantitative analysis (section 4) for more details on the financial impacts of these new contributions.

3.3.6 MiFID (see also appendix A – focus area 20)

On 21 October 2011, the European Commission issued its proposals for revisions to the Markets in Financial Instruments Directive (MiFID 1). The focus of the original MiFID was increased competition in markets and harmonised approaches to investor protection across the EU. In the wake of the financial crisis and subsequent turbulence in financial markets, a routine review has turned into what will likely become a full scale shake up of the market infrastructure and with significant repercussions for the power of supervisors and the protection of investors.

The proposals are a mix of "regulation" – which applies directly in each jurisdiction – and "directive" - which is subject to national implementation. The regulation ("MiFIR") covers transparency requirements, extensions to supervisory powers and new requirements for trading and access to clearing for derivatives. Investor protection proposals remain in the directive ("MiFID"), along with authorisation and organisational requirements for trading venues and financial service providers.

Some important implications of MiFID 2 include:

- Pre and post trade transparency requirements for equities are extended to other asset classes.
- Investment advisers are prevented from taking any inducements, and advisers face additional supervisory scrutiny of their cross-selling and product bundling practices.
- Product suitability measures including new checks / controls at point of sale as well as additional disclosures throughout the life cycle of the product.

Operating model

These additional rules will come at a significant cost to the industry. The operational costs of setting up the right technology infrastructures to comply with the additional data and reporting requirements alone are likely to be significant. Getting the simple initial reporting data right under MiFID 1 proved to be time consuming and expensive; MiFID 2 is even more complex.

Business model

It is also clear that business models will be affected: what will be the impact on the scope of products and services provided to wholesale, corporate and retail customers? What will be the impact on pricing and processes, and how will customers and competitors react?

3.3.7 Structural Reform (ring-fencing) (see also appendix A – focus area 26)

The various proposals for ring-fencing of retail bank activities from other more risky activities (e.g. trading) – such as the Liikanen recommendations in the European Union, but also proposals on a national level in Belgium – pose a number of key challenges for banks.

There is continuing uncertainty about where these proposals will end up as it is still unclear exactly which activities will be prohibited, limited or ring-fenced.

Financial situation

These measures are likely to increase costs. Ring-fencing will increase the overall capital that a banking group needs to hold, and it will increase the cost of funding. This will be true especially if different parts of the group receive different external credit ratings, as retail deposits cannot be used to fund trading activities, and separation strengthens the perception of creditors that some parts of banking groups are less likely to receive government support.

Operating model

Where banks are caught by one or more of these proposals, the challenge will be to assess how ring-fencing will apply to them, and its implications for the legal entity and operational structure of their groups.

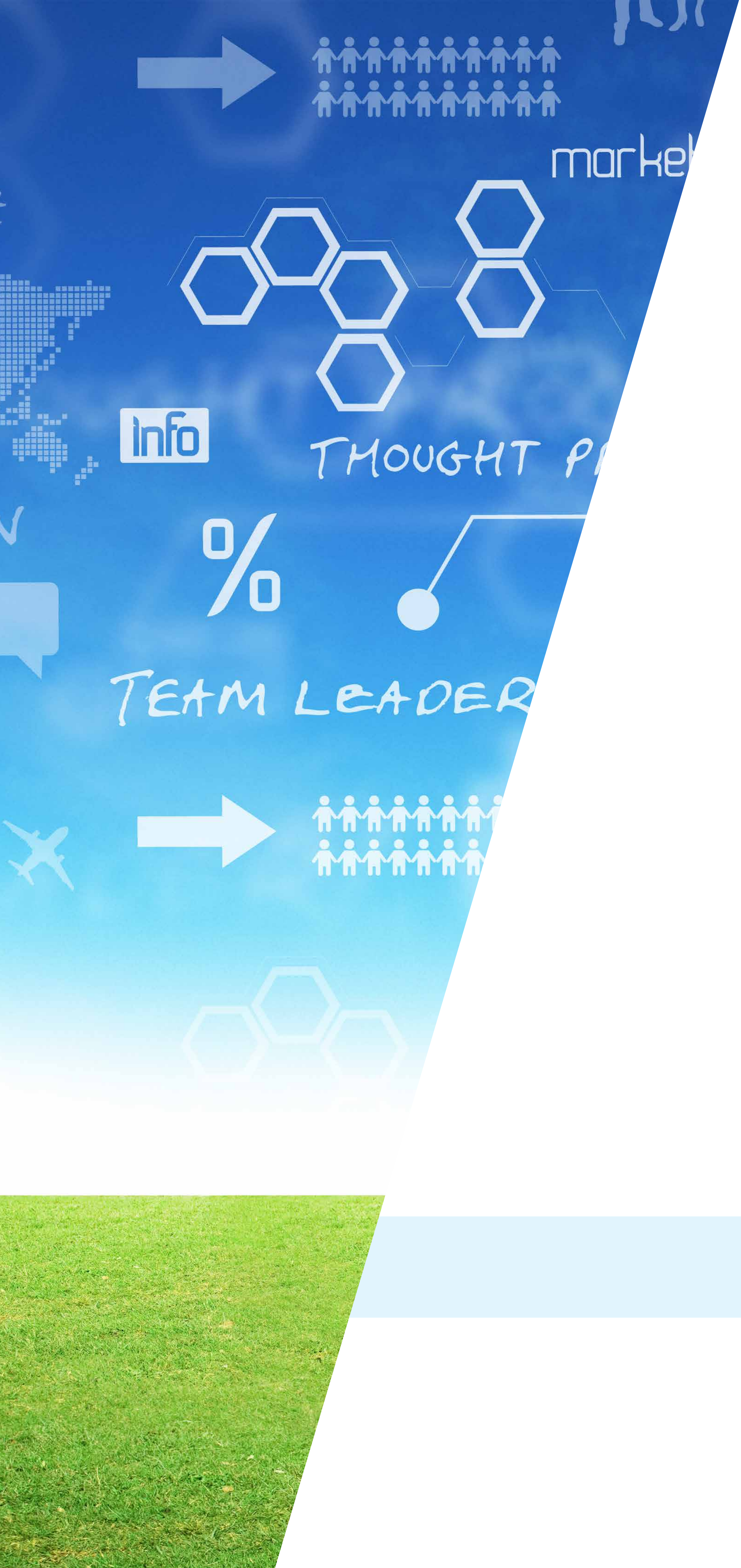
It will also be expensive to collect and monitor the data and information required to operate the ring-fence and to establish, operate and monitor the independence and separation of ring-fenced banks.

Business model

Banks may also find it challenging to provide services to large corporate companies across multiple entities, not only when these corporate companies place deposits in and borrow from, a ring-fenced bank but also when they require products and services that a ring-fenced bank is not allowed to provide. Assessing the commercial viability of current business activities will be a key task.

A final concern is whether banking groups can demonstrate that groups combining retail and investment banking can generate sufficient synergies and rates of return to justify their continued existence, while still meeting the proposals for structural separation.

Only the largest, most complex international banks are likely to face significant direct impacts from these requirements. However, the scale of change for these organizations – which together dominate the financial sector landscape – will inevitably have major implications for the operation of the market as a whole, and for the availability and price of key banking services.



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4. The quantitative effects of the accumulation of regulations

4.1 Introduction

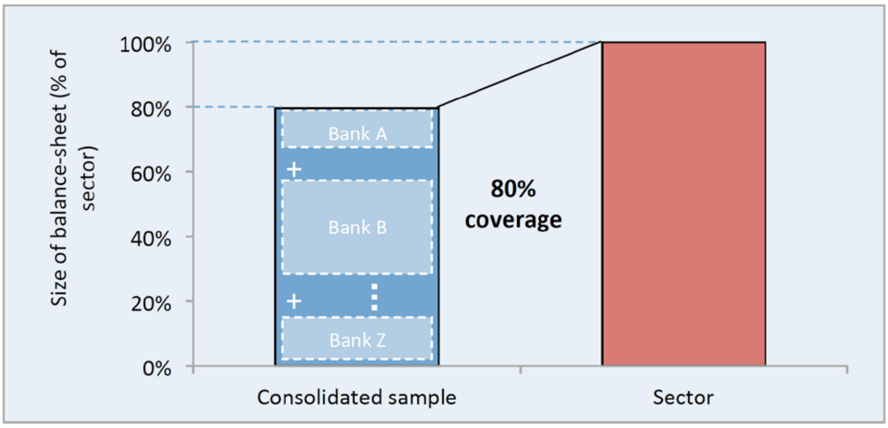
In addition to the qualitative analysis presented in the previous section, KPMG also identified the potential quantitative effects of the accumulation of regulations. This analysis primarily concerns the effects on the bank's financial situation (balance-sheet and income statement). Any possible macro-economic effects, such as the trend in the demand for loans under different economic scenarios, or lower risks on future state aid as a result of stricter legislation, have not been taken into account in this analysis.

First, the method is presented and the most important assumptions considered (section 4.2). Then, the impact of regulations for the period Q4 2012 to Q4 2016 is illustrated without taking into account possible actions (section 4.3 includes a base case scenario and a sensitivity analysis on the input parameters). These are analysed and their feasibility determined (section 4.4). Then, KPMG simulated three alternative mixes of management actions (section 4.5). Finally, the results of this study are compared with the results obtained from a similar study conducted by the international KPMG network in the Netherlands in 2012 (section 4.6). The purpose is to provide more insight for policy makers and other stakeholders on what can be expected from the banking sector on average.

4.2 High-level description

High-level data (balance-sheet, income statement and Basel III items[23]) have been collected from individual banks and then aggregated in order to produce a consolidated view at Q2 2012 (section 4.2.1 covers the consolidation of data). The sample of participating banks represents about 80% of the Belgian banking sector in terms of size of balance-sheet, as illustrated in Figure 13.

Figure 13 : Representativeness of the sample in terms of the size of the balance-sheet



[23] Basel III items are retrieved from the official banks' Basel III monitoring sheets that are submitted to the National Bank of Belgium.

Starting from the 2012 Q2 aggregated figures, the model that forms the basis for the analysis projects the balance sheet as adjusted for the most important Basel III effects (post-implementation) and the overall profitability until the end of 2016. Assumptions underlying these projections are further explained in section 4.2.2.

The next step consists of integrating the effects of the regulations in the model's projections applied. Figure 14 shows which of the top seven regulations (based on the results of the qualitative analysis in section 3) have been included in the quantitative analysis. The selection focused on the rules that are expected to have the biggest impact on banks' financial situation and that are sufficiently quantifiable. More detailed information on how these regulations have been taken into account in the model is provided in section 4.2.3.

The table below clearly demonstrates that the results of our quantitative analysis can only demonstrate a portion of the real cumulative impact of new regulations. This is because, first only the direct impacts of the selected rules have been taken into account. And second, many other rules (e.g. IFRS, MIFID, structural reform, etc.), not included in the quantitative study, also have important direct and indirect impacts on banks' financial situation, business model, operating model, and change capacity. The overall result of which represents additional challenges to address.

Finally, the "performance" of the sample was measured in terms of compliance with Basel III and profitability ratios (section 4.2.4 provides more details on the target ratios applied).

Figure 14 : Selection of regulations for the quantitative analysis

Top seven regulations	Effect on financial situation	Effect on business model	Effect on operating model	Effect on change capacity	Covered by quantitative analysis
CRD IV / Basel III	Large impact	Large impact	Average impact	Average impact	✓
International Financial Reporting Standards (IFRS)	Average impact	Limited impact	Average impact	Average impact	✗
Crisis Management & Bank resolution (including bail-in)	Limited impact	Limited impact	Average impact	Average impact	✓
Financial Transaction Tax (FTT)	Limited impact	Limited impact	Limited impact	Limited impact	✓
Deposit Guarantee Scheme and bank contributions	Limited impact	Average impact	Limited impact	Limited impact	✓
Markets in Financial Instruments Directive & Regulation (MiFID)	Not applicable	Limited impact	Average impact	Average impact	✗
Structural reform (including ring-fencing)	Limited impact	Limited impact	Limited impact	Limited impact	✗

Scoring system

- Not applicable
- Limited impact
- Average impact
- Large impact

4.2.1 Consolidation of data

The high-level data (balance-sheet, income statement and Basel III items) collected from individual banks have been aggregated to feed the model with consolidated figures as explained below.

Financial situation

The consolidated balance-sheet has been obtained by summing assets and liabilities of the participating banks classified under the following categories:

- Assets
  - cash and central bank reserves;
  - debt securities, i.e. transferable securities (including Level 1 and Level 2 assets) minus corporate shares and other equity;
  - loans and receivables: all loans except those granted to credit institutions; and
  - other assets including fixed assets, claims on credit institutions, corporate shares and other equity.
- Liabilities
  - shareholder's equity: own resources including capital and reserves;
  - "debts to clients", i.e. retail deposits; term accounts, etc.;
  - other funding including debt issuances, subordinated debt and "due to banks"; and
  - other liabilities.

Basel III items

Consolidated Basel III ratios have been obtained by summing up numerators and denominators of the ratios as provided by individual banks.

The ratios calculated are:

Common Equity Tier 1 (CET1) Ratio = CET1 / Risk Weighted Assets (RWA)

Leverage Ratio = Tier 1 capital / (total assets + add-on)

Liquidity Coverage Ratio (LCR) = HQLA / Net stressed cash outflow

Net Stable Funding Ratio = Available Stable Funding (ASF) / Required Stable Funding (RSF)

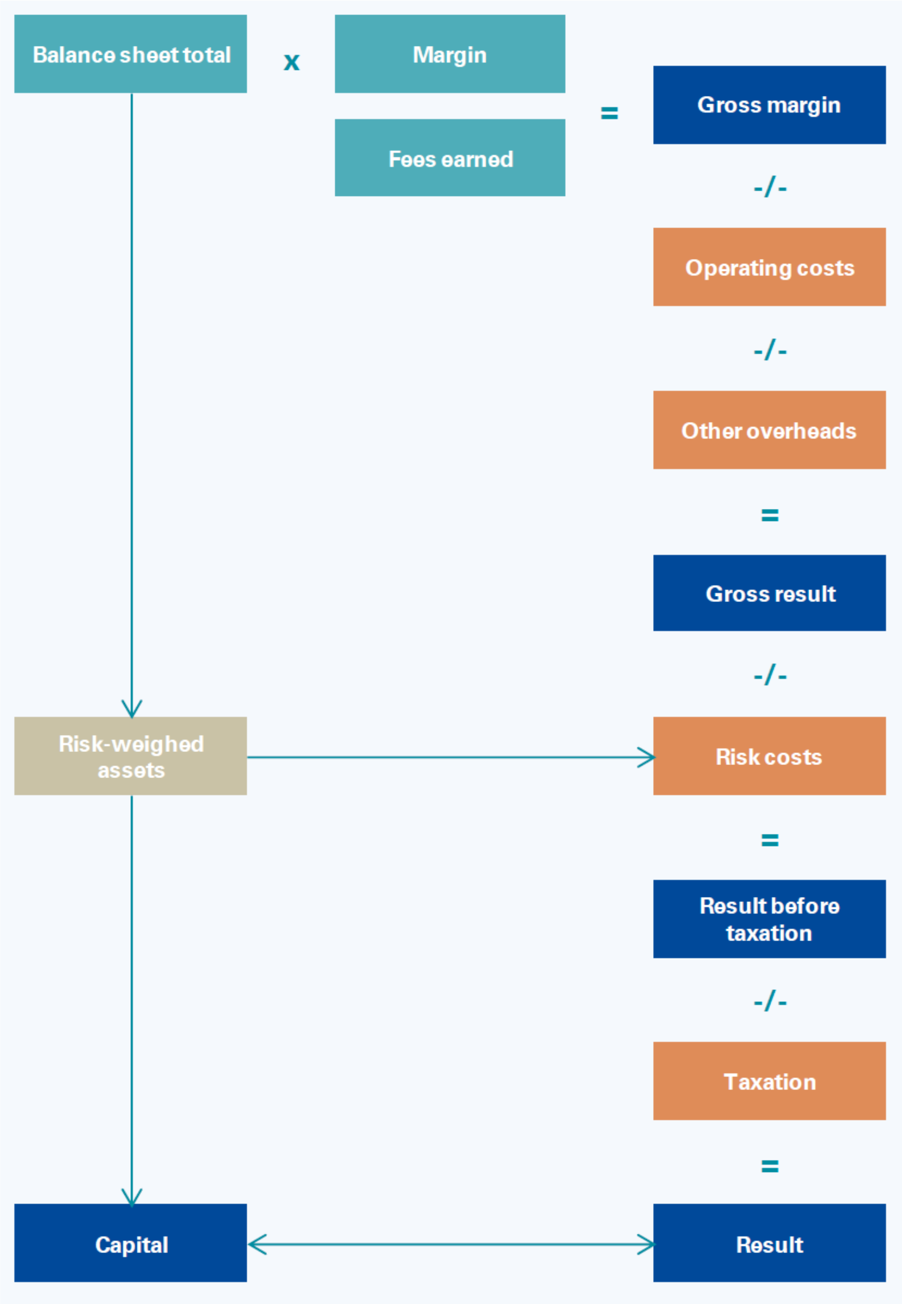
Profit and loss

Aggregation of profit and loss has been completed based on the simplified bank's profitability model illustrated in Figure 15.

In this model, the consolidated result is primarily determined by the following factors: a) interest income; b) operating expenses; and c) other income (such as commission income and trading activities).

The interest-based operations generate an interest margin, while the advisory operations generate fees income. Together, the interest margin and the fees represent the consolidated bank's income. Costs incurred by the banks are deducted from this total. To determine the result, the risk costs (e.g. write-downs of investments or loans and taxes payable) are deducted from the gross result. Should this result in a profit, it can be used, among other things, to strengthen capital or be distributed to the shareholders.

Figure 15 : Illustration of the simplified bank's business model



Source: KPMG analysis

4.2.2 Assumptions under base case scenario

The analysis starts with the elaboration of a base case scenario. In this scenario, no management action is taken by the sector and a number of assumptions were applied to obtain the most accurate picture for the period Q4 2012 to Q4 2016. KPMG presented and discussed these assumptions with experts and economists from the banks that participated in the survey. A sensitivity analysis has been performed based on some of the most significant assumptions. The results are presented in section 4.3.

Representativeness

It is assumed, that the consolidated sample data is representative for the Belgian banking sector as the combination of participating banks represents about 80% of the Belgian banking sector in terms of balance-sheet. In addition, both larger and smaller banks are represented in the sample.

It is also assumed that Q2 2012 data is representative for 2012 end-of-year figures. Note however that some corrections have been made for non-recurring items in Q2 2012 figures and for anticipated changes between Q2 2012 and Q4 2012.

Financial situation

The balance-sheet is assumed to remain static (stable size and structure) with the exception of the following items:

- Retained earnings
  It is assumed that earnings are partly retained to strengthen the capital position (i.e. 60% retained earnings). These earnings are held as cash and positively affect the liquidity coverage ratio (LCR).
- Organic growth of the "debts to clients"
  It is assumed that there is a constant growth of the "debts to clients" of 2% on a annual basis. In the scenario where the balance-sheet is constant, the increase in the "debts to clients" is compensated by a decrease from other sources of funding by an equivalent amount. This is assumed to have a positive effect on the net stable funding ratio (NSFR).
- State-aid repayment
  It is assumed that the remaining state-aid to banks (~EUR 2.25 billion nominal as of 31 December 2012) will be paid back by 2020 according to the schedule illustrated in Figure 16 below, i.e. EUR 0.75 billion capital + 50% premium repaid in the first half of 2013 and tranches of EUR 0.21 billion capital + 50% premium repaid annually from 2014 to 2020.
- Repayment of Long-Term Refinancing Operations (LTRO[24]) support
  For the estimated EUR 35 billion of Long-Term Refinancing Operations (LTRO, both rounds) that large Belgian banks benefited from, the following repayment schedule has been assumed: ~EUR 14 billion in 2013, and ~ EUR 10.5 billion in 2014 and 2015.

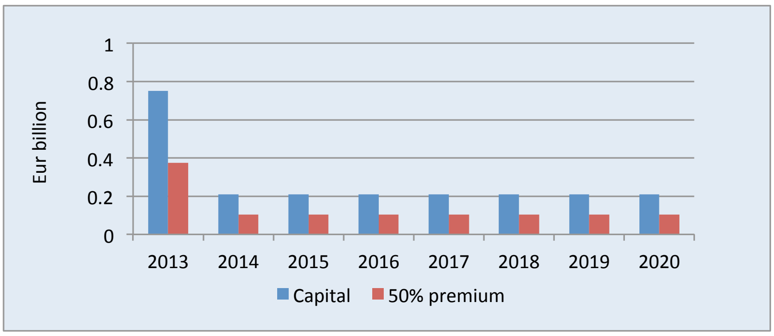
  For the purpose of the quantitative analysis, and based on discussions with the participating banks, it has been assumed that the amounts borrowed by the banks under LTRO have been partly used to invest in sovereign bonds (high-quality liquid assets) and partly placed as overnight deposits in the ECB.

  It has been further assumed that only 50% of LTRO is replaced by other funding sources at maturity.

  The resulting impact for the part that is not replaced is on the following:

  - the size of the balance-sheet (i.e. a balance-sheet decrease);

Figure 16 : Assumed state-aid repayment schedule for the banking sector



[24] LTRO: a process by which the ECB provided longer-term financing to euro-zone banks

- the interest revenues/costs (i.e. a combination of a decrease in interest revenues due to a reduction of O/N deposits at the ECB and a decrease in funding costs due to the repayment of LTRO); and
- the amount of available stable funding (i.e. a progressive reduction of the weight attracted by LTRO funding in the calculation of available stable funding, from 100% to 50% when the residual maturity is less than one year, and 0% once the LTRO is repaid).

For the part that is replaced by other funding sources at maturity, it can be assumed that there is:

- no impact on the interest costs (i.e. LTRO is replaced by short-term funding at the same cost);
- no impact on the LCR (net stressed cash outflows) (i.e. the new funding is backed by the same level of assets); but
- an impact on the amount of available stable funding (i.e. a progressive reduction of the weight attracted by LTRO funding in the calculation of available stable funding, from 100% to 50% when residual maturity is less than one year, and then 0% when LTRO is repaid (i.e. new funding attracts 0% weight[25])).

Profit and loss

- It is assumed that the 2012 profitability serves as a good proxy for future profitability[26]. Profitability is rolled forward, which implies that the interest margin is constant and that similar operational and risk-related costs are incurred.

4.2.3 How regulations are taken into account in the model

Basel III / CRD IV

The quantitative analysis began with two steps. The first step was a projection of the consolidated balance-sheet and income statement for the sample of participating banks for the period of 2012-2016. The second step was an assessment of the consolidated profitability and Basel III ratios compared against the minimum levels and target levels required either by the Basel III regulation or imposed by overall market discipline (section 4.2.4 provides more information on the minimum and target levels used in the model). In this base case scenario where no management actions are yet considered, no additional cost for Basel III implementation is included in the model.

Deposit Guarantee Scheme and Bank Contributions

For the purpose of the quantitative analysis, updates or changes to the existing bank contributions used to establish funds, like the resolution and deposit protection funds, have been taken into account as additional yearly operating costs.

For the purpose of estimating costs, the figures were taken from a study performed by Febelfin[27 28] and adapted to take into account the sample size (i.e. 80% of the sector in terms of the size of the balance-sheet).

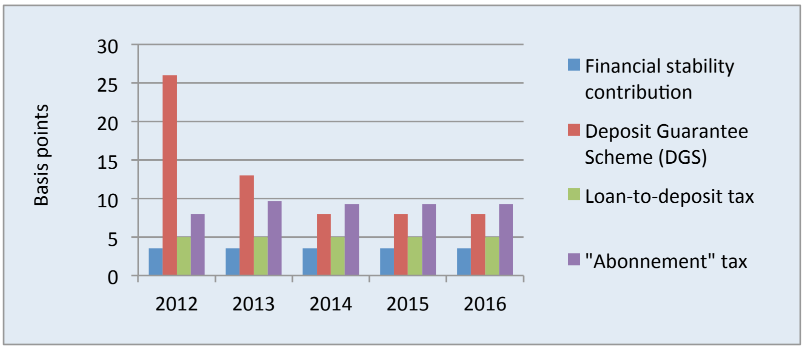
25 Conservative assumption

26 The stability of operational costs assumes restructuring or cost reductions that compensate for salary indexation.

27 Febelfin, Contribution bancaire, June 2012

28 When a cost estimate was available for 2012 and the following years, we took those figures as such and scaled them to the size of our sample. When a cost estimate was only available for 2012, we derived cost estimates for following years mainly by multiplying the simulated tax base with the applicable tax rate (see Figure 17 for the expected evolution of tax rates in basis points).

Figure 17 : Expected evolution of bank contributions (tax rate)



Financial stability contribution (contribution to the resolution fund)

The new financial stability contribution, which has been applied to all Belgian based banks since 2012, amounts to 3.5 basis points on the total amount of liabilities, minus the equity and deposits subject to the guarantee scheme. The cost estimated by Febelfin for 2012 is ~ EUR 0.25 billion for the Belgian banking sector (i.e. ~EUR 0.2 billion for our sample).

Deposit Guarantee Scheme (DGS)

The contributions to the deposit protection fund, which are calculated as a levy (26 basis points in 2012, 13 basis points in 2013 and 8 basis points beginning in 2014) on the total amount of guaranteed deposits, have been estimated by Febelfin at ~ EUR 0.84 billion for the Belgian banking sector in 2012 (i.e. ~ EUR 0.67 billion for our sample). From this 2012 cost estimate, an amount of guaranteed deposits has been calculated, and the contributions for the 2013-2016 period have been projected based on the assumption that guaranteed deposits will grow at the same rate as "debts to clients" (i.e. 2%).

"Loan-to-deposit" tax

The "loan-to-deposit" tax is due on regulated savings deposits. It amounts to five basis points multiplied by the portion of exempt interest compared to the total amount of interest paid, multiplied by a factor (ranging from 60% to 240%) depending on the amount of European loans that are not granted to financial institutions. The contributions have been estimated by Febelfin at ~EUR 0.08 billion for the Belgian banking sector in 2012 (i.e. ~ EUR 0.065 billion for our sample). Contributions are then assumed to grow at same rate as the "debts to clients" (i.e. 2%) during the period of 2013-2016.

"Abonnement" tax

The "Abonnement" tax is due on regulated savings deposits. It amounts to eight basis points until 2012, 9.65 basis points in 2013 and 9.25 basis points beginning in 2014. The relative impact compared to 2012 has been estimated by Febelfin at EUR 40 million in 2013 and EUR 30 million beginning in 2014, for all Belgian banks (for our sample EUR 32 million in 2013 and EUR 24 million beginning in 2014).

Bail-in debt (crisis management framework)

Regulators still have to determine the exact rules they want to use for implementing the bail-in regime, but the European Commission has already indicated that there will be no exceptions to debt already incurred by banks (no grandfathering). Consequently, the current market consensus is that funding providers will apply a surcharge, based on this risk (conversion) to debt.

In the model, the costs associated with bail-in debt are phased in over the 2013-2016 period and are calculated at a surcharge of ~28 basis points on ~33% of current liabilities (i.e. an increase of cost of funding). Here the assumption is that the regulator will apply a comprehensive approach to funding that can be converted into equity. This approach differs from a targeted approach under which resolution authorities could require credit institutions to issue a fixed volume of "bail-inable" debt.

Our assumptions are essentially based on the impact assessment performed by the EU Commission[29]. In the working document issued in June of 2012, the EC refers to two policy options in regards to the scope of liabilities eligible for bail-in:

- Comprehensive bail-in in which unsecured debt, uncovered deposits and unsecured interbank exposures with more than one month original maturity are eligible for bail-in;
- Restricted bail-in, in which only unsecured long term debt and uncovered deposits (with more than one year original maturity) are eligible for bail-in.

According to EC estimate[31], under the comprehensive bail-in (conservative approach), the total "bail-inable" debt would represent ~38% of total liabilities for an average EU bank (2009). As the proportion of guaranteed deposits in our sample is 5% higher than for the average EU bank considered for the EC estimate, we further adjusted that number by 5% to reach 33%.

In regards to the increase in funding costs of "bail-inable" liabilities due to the introduction of bail-in, the EC considers that the expected surcharge of 87 basis points estimated by a JP Morgan survey[30] is overestimated and could be reduced to 28 basis points. The EC provides the following two reasons for the change in basis points:

- The EC assumes that the use of bail-in in combination with other rules of the crisis management package will result in a lower LGD (loss given default) for bond holders than the historical average and that they will therefore accept a lower credit spread.
- The EC also expects the market to assume that, although bail-in can basically be applied to all the banks, regulators will only use this instrument in practice for systemically important banks. This will result in lower total costs for the banking sector.

Financial Transaction Tax (FTT)

The proposal for a Council Directive for the implementation of enhanced cooperation in the area of financial transaction tax that was adopted by the European Commission on 14 February 2013 foresees taxation of all transactions with an established link to the FTT-zone at a rate of 0.1% for shares and bonds, and 0.01% for derivatives.

For the purpose of the quantitative analysis, FTT has been taken into account as an additional yearly operating cost in the model. The estimate of that cost is based on the impact assessment performed by the European Commission. According to the February 2013 EC press release[31], the Financial Transaction Tax is expected to deliver revenues of EUR 30-35 billion a year when applied by the 11 Member States[32].

To estimate what part of that cost could be applied to the sample of participating banks, the figure was first scaled down to the scope of Belgium by using GDP as a scaling factor. This leads to an estimate of EUR 1.6 billion for Belgium. Then taking into account the size of the sample (~80% of the Belgian banking sector) and the importance of the banking sector in financial transactions (~75%), the yearly impact is assumed to be about EUR 1 billion as from 2014[33].

Note that a recent study performed by the National Bank of Belgium and Febelfin concludes that the financial transaction tax could cost as much as EUR 8.4 billion to the four largest Belgian banks (press article dating of April 2013). According to Febelfin however, this cost estimate, does not take into account behavioural changes. The real cost could then be lower, as some of the financial transactions will simply no longer occur, while others will migrate to countries where the tax is not applicable.

4.2.4 Target ratios applied

As the analysis consists of assessing the "performance" of the sample in terms of compliance with Basel III and profitability ratios, minimum and target levels for the end of 2016 were set for each one of the six ratios (see Figure 18 on following page).

29 EC commission, Impact assessment, June 2012, http://ec.europa.eu/internal_market/bank/docs/crisis-management/2012_eu_framework/impact_assessment_final_en.pdf
30 JP Morgan. European Bank Bail-In Survey – Results. October 2010.
31 http://europa.eu/rapid/press-release_IP-13-115_en.htm
32 The expected revenues take into account behavioural changes
33 However, KPMG took note of recent comments in the press that impact of FTT could be softened quite drastically.

Figure 18 : Minimum and target levels for Basel III and profitability ratios

Proposed target ratios			
Ratio	**2012 YE (post Basel III impact)**	**Minimum 2016**	**Target 2016**
Common Equity Tier 1 ratio	9.3%	7%	11%
Leverage Ratio	3.5%	3%	3.5%
NSFR	117%	100%	110%
LCR	90%	100%	110%
ROE	5.9%	5.9%	8%
C/I ratio	68%	N/A	65%

Although Basel III/CRD IV has a phasing-in period, "market discipline" can be assumed to result in banks complying with the minimum Basel III capital and liquidity requirements by the end of 2016.

Moreover, there are also minimum market expectations in certain areas, such as returns on equity or cost/income ratios. Banks can be assumed to – within traditional market dynamics – want to at least meet these minimum expectations, but also retain sufficient flexibility to not end up immediately in a non-compliant situation in the event of possible market volatility.

In consultation with the participating banks, the main target ratios for the Belgian banking sector – on average – have been defined as follows:

- Common Equity Tier 1 ratio: 11%

  The new counter-cyclical and system buffers increase the minimum capital buffers of 7% CET1. In addition to which, an additional buffer is necessary to absorb fluctuations in the event of market volatility to ensure some degree of certainty to continue satisfying the requirement. 11% was seen as a realistic target CET1 ratio for 2016.

- Leverage ratio: 3.5%

  In order to absorb fluctuations in times of market volatility, the target ratio for 2016 was set at 3.5%.

- NSFR: 110%

  Discussions with the sector show that a target ratio of 110% is considered sufficient for meeting the statutory minimum requirement of 100%.

- LCR: 110%

  The revised liquidity standard adopted by the Basel Committee on Banking Supervision in January 2013, foresees a phasing-in of the minimum LCR so that the required LCR is 60% in 2015, rising by 10 percentage points a year until it reaches 100% from 2019 onwards. It is assumed that the market will still require a minimum LCR of 100% as from 2013. A target ratio of 110% is thus applied.

- Return on equity (ROE): 8%

  Return on equity levels of banks in Belgium have decreased significantly compared to pre-crisis levels (see Figure 19 on following page for average historical ROE for some banks in Western Europe on the period 2004-2012).

  It has been observed that the industry tends to find ways to restore RoE to these higher levels. However, a RoE in the mid teens, as we have seen historically, seems to be unrealistic in the current economic climate, which is to some extent still characterized by asset deflation and impairment, weak economic growth and excess industrial capacity.

  KPMG believes that an average industry RoE of around 8% is considered a healthy long term return, given the current sustainable industry cost of equity of approximately 8% combined with a low equity spread. However, substantial variation between banks will exist, given the disparity between capital structure, business models and the related risk profile.

The 2016 target return on equity has been set at 8% in the study.

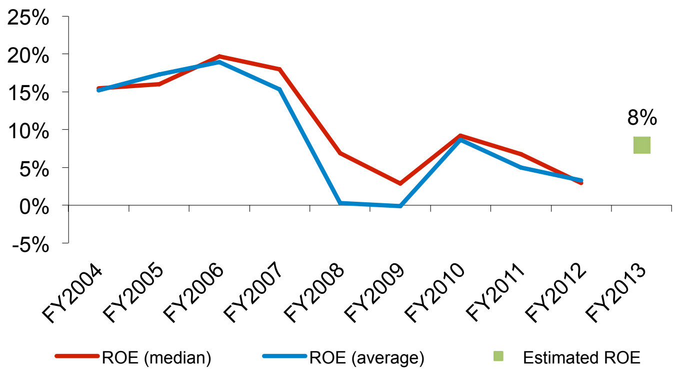
- Cost income ratio

  The cost income ratio is the ratio between operating costs (including Financial Transaction Tax and bank contributions) and gross income (i.e. the sum of net interest income and other net income). The target ratio for the sector was set at 65%[34].

4.3 Results for the base case scenario including the effects of new regulations

Figure 20 (on the following page) illustrates the evolution of the Basel III and profitability ratios under the base case scenario for the period of Q4 2012 to Q4 2016, including the impact of new regulations. This does not take into account the possible management actions to be taken by the banks. It shows that, in the situation outlined below, the Belgian banking sector will not meet all the minimum requirements and the target ratios for year-end 2016. In our opinion, although not all target ratios are reached by 2016, the Belgian banking sector is relatively healthy with regard to solvency and liquidity. It is striking however that profitability is seriously affected by all the regulations and can be interpreted as difficult to sustain without appropriate measures being taken.

Figure 19 : Historical and expected ROE for Western Europe banks



Source: Bloomberg and analyst reports, KPMG analysis

[34] This target ratio differs significantly on an individual bank level, due to the different business models in place

Figure 20: Evolution of ratios under base case scenario

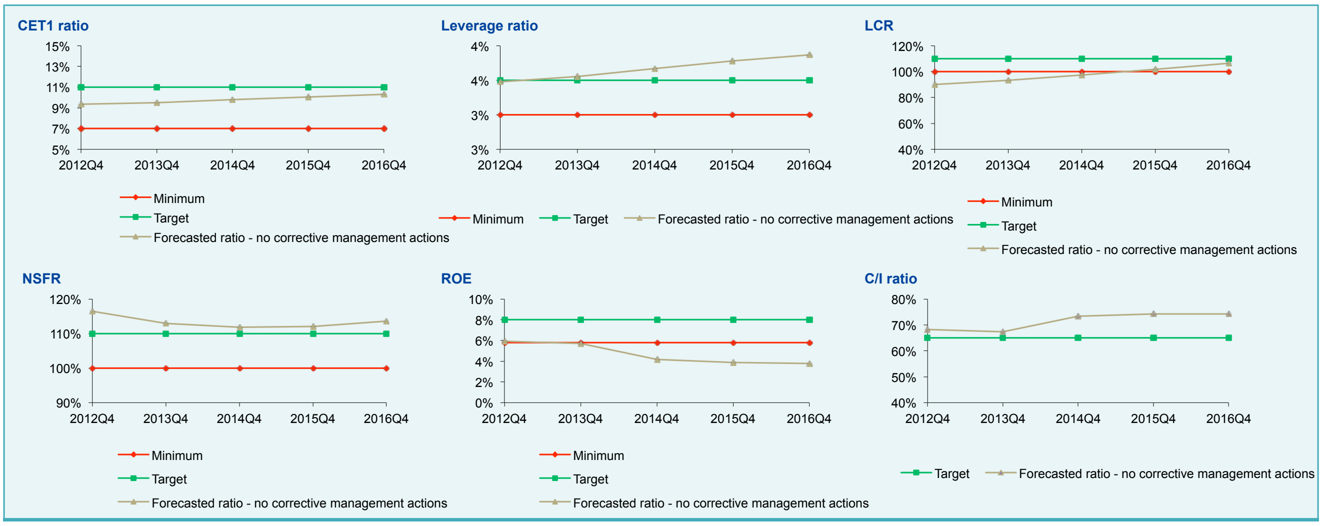


Figure 21 (on the following page) shows the evolution of each ratio and its components, for the period between Q4 2012 and Q4 2016. The evolution of the ratios can be explained by following elements.

- The evolution of the Common Equity Tier 1 ratio is mainly driven by the strengthening of Common equity tier 1 capital due to the profit retention policy.
- The evolution of the leverage ratio is mainly driven by the strengthening of Tier 1 capital due to the profit retention policy and the reduced asset base linked to repayment and not replacement of part of LTRO funding and repayment of state-aid.
- The evolution of the Liquidity Coverage Ratio is mainly driven by an increase in high-quality liquid assets due to the profit retention policy combined with a reduced net stressed cash outflows, as a result of a 2% growth of "debts to clients" and a reduction at an equivalent amount of other sources of funding that attract a higher weight for the calculation of stressed cash outflows.
- The evolution of the NSFR Ratio is mainly driven by the repayment of LTRO funding, which has a negative impact on the available stable funding during the 2013-2015 period, compensated by a 2% growth of "debts to clients", which generates additional available stable funding and makes the NSFR ratio increase again beginning in 2015.
- The evolution of the ROE Ratio[35] is mainly driven by the progressive introduction of new regulations (i.e. DGS and other bank contributions, FTT, bail-in). These regulations reduce the interest rate margin and increase the operational costs which results in a deteriorated net income after tax. This is then combined with a profit retention policy, which increases the shareholder's equity and negatively impacts the ROE. Under current assumptions, the ROE ends up at a level of 3.8% at Q4 2016[36], which is below the applied minimum of 5.9% considered by the participating banks.
- The evolution of the cost/income ratio is mainly driven by the progressive introduction of new regulations (i.e. DGS and other bank contributions, FTT, bail-in), which reduce the interest rate margin and increase the operational costs. Under current assumptions, the cost/income ratio ends up at a level of 74% at Q4 2016[37].

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35 For the ROE calculation, shareholder's equity is estimated by CET1 prior to regulatory adjustments.
36 Without FTT, ROE would end up at 4.9% for Q4 2016 (see the sensitivity analysis results in Figure 17).
37 Without FTT, the cost / income ratio would end up at 68% for Q4 2016.

Figure 21 : Analysis of ratios and their components[38]

Basel III ratios	2012Q4 → 2013Q4		2013Q4 → 2014Q4		2014Q4 → 2015Q4		2015Q4 → 2016Q4	
CET1	(2)	↗	(2)	↗	(2)	↗	(2)	↗
Risk weighted assets EoP	(1)	→	(1)	→	(1)	→	(1)	→
CET1 ratio		**9,3% → 9,5%**		**9,5% → 9,8%**		**9,8% → 10,1%**		**10,1% → 10,3%**
Stock of HQLA	(2)	→	(2)	↗	(2)	↗	(2)	↗
Net stressed cash outflows	(8)	↘	(8)	↘	(8)	↘	(8)	↘
Liquidity Coverage Ratio (LCR)		**90,1% → 93,4%**		**93,4% → 97,5%**		**97,5% → 101,9%**		**101,9% → 106,6%**
Available stable funding	(2),(7),(8)	↘	(2),(7),(8)	↘	(2),(7),(8)	→	(2),(8)	↗
Required stable funding	(1)	→	(1)	→	(1)	→	(1)	→
Net stable funding ratio (NSFR)		**116,5% → 113,%**		**113,% → 111,8%**		**111,8% → 112,%**		**112,% → 113,6%**
Tier 1	(2)	↗	(2)	↗	(2)	↗	(2)	↗
Adjusted Assets	(2),(7)	→	(2),(7)	→	(2),(7)	→	(2)	→
Leverage ratio		**3,5% → 3,6%**		**3,6% → 3,7%**		**3,7% → 3,8%**		**3,8% → 3,9%**
Profitability ratios	**2012Q4 → 2013Q4**		**2013Q4 → 2014Q4**		**2014Q4 → 2015Q4**		**2015Q4 → 2016Q4**	
Net income after corporate tax	(5),(6),(7)	↗	(4),(5),(6),(7)	↘↘↘	(6)	↘↘		→
Average Shareholder's equity over period	(3)	↗↗	(3)	↗	(3)	↗	(3)	↗
ROE		**5,9% → 5,7%**		**5,7% → 4,2%**		**4,2% → 3,9%**		**3,9% → 3,8%**
Operational costs	(5)	↘	(5),(4)	↗↗		→		→
Net interest income + net other income	(6)	↘	(6)	↘	(6)	↘		→
Cost / Income ratio		**68,2% → 67,3%**		**67,3% → 73,4%**		**73,4% → 74,3%**		**74,3% → 74,3%**

Legend

-1000%	↘↘↘	Decrease by more than 10%
-10%	↘↘	Decrease by more than 5% but less than 10%
-5%	↘	Decrease by more than 1% but less than 5%
-1%	→	Change by less than 1%
1%	↗	Increase by more than 1% but less than 5%
5%	↗↗	Increase by more than 5% but less than 10%
10%	↗↗↗	Increase by more than 10%

Comments / impacts

(1)	Maintained constant
(2)	Ret. earnings (+), Pay-back state-aid cap/prem (-)
(3)	Ret. earnings (+), Pay-back state-aid premium (-)
(4)	Introduction of FTT
(5)	Reduction in DGS costs
(6)	Additional bail-in costs
(7)	LTRO repayment
(8)	Growth of "debts to clients"

Cumulative cost impact of new regulations

The cumulative effect of the regulations is illustrated in Figure 22 (on the following page).

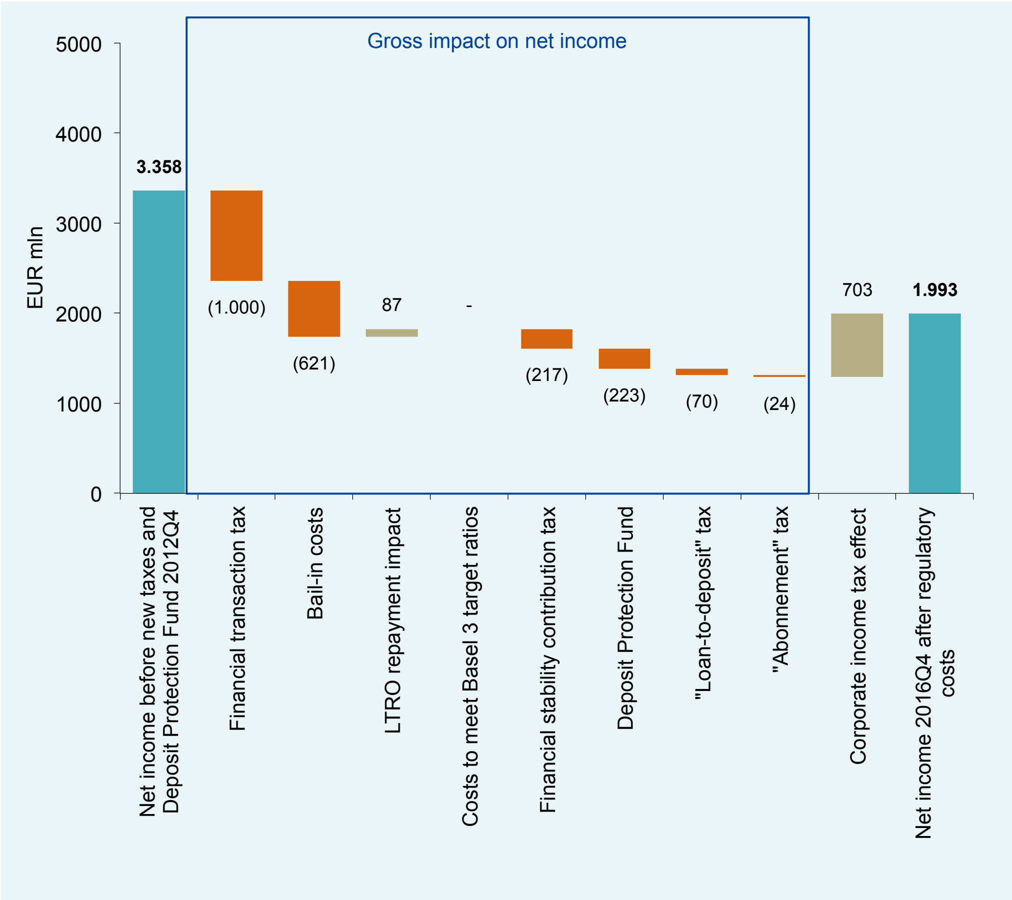
The table shows the gross impact (before tax) of the Financial Transaction Tax, bail-in, DGS and other bank contributions on the 2016 profitability (after tax). The impact of the Financial Transaction Tax (i.e. EUR 1 billion before tax) represents the largest impact on profitability for the consolidated sample of banks. The next most important are the bail-in cost (i.e. EUR 621 million before tax) and the bank contributions (financial stability contribution tax, Deposit Protection Fund, "loan-to-deposit" tax and "Abonnement" tax).

It was noted that there is a relatively speaking small positive effect of EUR 87 million on net income before tax for the part of LTRO that is repaid but not replaced, as we assume a stronger decrease in funding costs due to repayment of LTRO than the decrease in interest revenues due to the reduction of overnight deposits at ECB.

There is also a positive effect of EUR 703 million, which corresponds to the corporate income tax effect on new regulations.

[38] For each period and component, an arrow indicates whether the component has increased or decreased during the period and by how much (see scale in legend). The colour of the arrow indicates whether the evolution of the component is beneficial to the ratio (blue colour) or not (red colour). For each period and component, a number in brackets refers to a short explanation on the evolution of the component.

Figure 22 : Cumulative cost impact of new regulations



Sensitivity analysis on input parameters

The results for the base case scenario were obtained under a number of key assumptions, which have an impact on the final outcomes and thus on the package of measures that will be necessary to meet the required target ratios.

The values of the main assumptions used in the quantitative analysis (base case scenario) are:

- cost of risk, i.e. the ratio between impairments and the total amount of loans and receivables: 0.25%;
- bail-in effect: a 28 basis points increase in the cost of funding for 33% of liabilities;

- retained earnings: 60%;
- Financial Transaction Tax: EUR 1 billion; and
- annual growth rate of "debts to clients": 2%.

Figure 23 provides also insight into the degree of sensitivity of the outcomes of this analysis with respect to the assumptions applied. For individual assumptions, both a pessimistic and an optimistic value were applied to calculate the impact on the relevant ratios. Two extreme scenarios, which simultaneously combine the entire positive or negative values to individual assumptions, have also been added. Note that under the extremely negative scenario, none of the target ratios are reached.

Figure 24 (on the following page) illustrates the same sensitivity analysis results in a graphical form. From the graphs, we can observe the following points:

- Assumption related to retained earnings has a significant impact on CET1 and leverage ratios.
- NSFR and LCR ratios are strongly dependent on the assumption of the annual growth rate of "debts to clients" as this rate has a direct impact on amount of available stable funding and stressed cash outflows.
- Profitability ratios are mainly driven by the overall cost that new regulations will bring (i.e. FTT, bail-in and bank contributions).

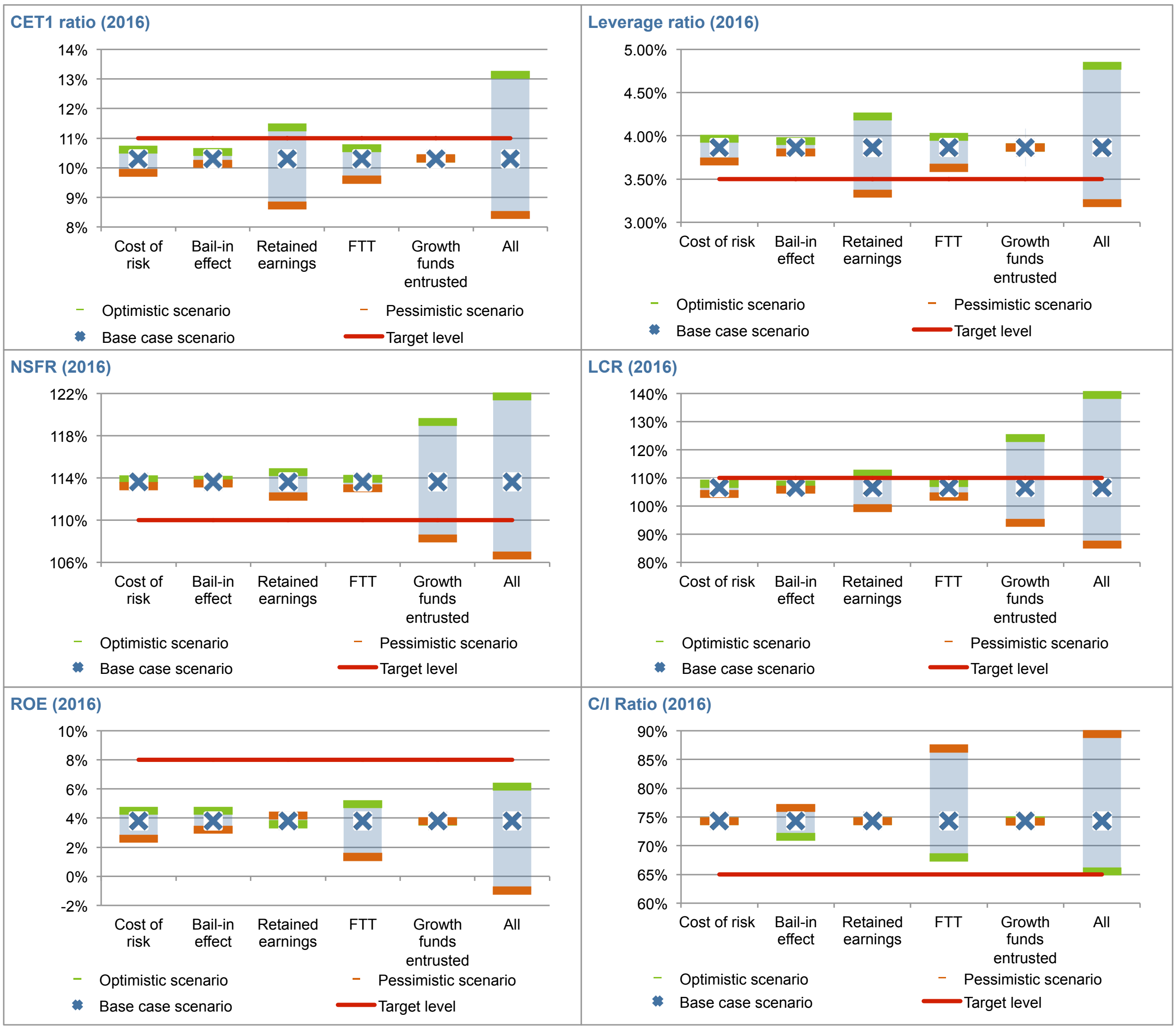
Figure 23 : Sensitivity analysis on input parameters

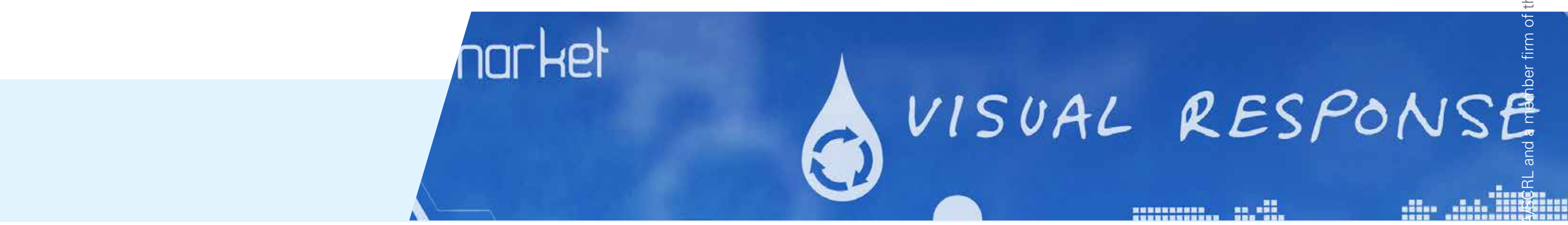
Results sensitivity analysis of most significant input parameters

2016 ratios	Assumed value	Pessimistic & optimistic values	Core tier 1	Leverage ratio	LCR	NSFR	ROE	C/I
Targets			11,0%	3,5%	110,0%	110,0%	8,0%	65,0%
Base case scenario			10,3%	3,9%	106,6%	113,6%	3,8%	74,3%
Sensitivities input parameters								
Cost of risk (% loans and receivables)	(0,25)%	(0,5)%	9,8%	3,7%	104,4%	113,2%	2,6%	74,3%
		(0,1)%	10,6%	4,0%	108,0%	113,9%	4,5%	74,3%
Bail-in effect	28.3 bps	50 bps	10,1%	3,8%	105,8%	113,5%	3,2%	76,6%
		0 bps	10,5%	3,9%	107,6%	113,8%	4,5%	71,5%
Retained earnings	60,0%	-	8,7%	3,3%	99,2%	112,2%	4,2%	74,3%
		100,0%	11,4%	4,2%	111,5%	114,5%	3,6%	74,3%
Financial Transaction Tax	EUR 1 bn	EUR 3 bn	9,6%	3,6%	103,3%	113,0%	1,3%	86,9%
		-	10,7%	4,0%	108,2%	113,9%	4,9%	68,0%
Annual growth funds entrusted	2,0%	-	10,3%	3,9%	94,0%	108,3%	3,8%	74,2%
		4,0%	10,3%	3,9%	124,2%	119,3%	3,8%	74,4%
All parameters together			8,4%	3,2%	86,2%	106,6%	(1,0)%	89,5%
			13,1%	4,8%	139,5%	121,7%	6,2%	65,5%

Green = ratio meets target; Red = ratio does not meet target

Figure 24 : Sensitivity analysis on input parameters





4.4 Anticipated response of the Belgian financial sector

4.4.1 Description of plausible actions

In order to achieve the target ratios, KPMG identified various measures that would make a positive contribution and are also sufficiently quantifiable. These potential measures and their impact on the ratios are illustrated in Figure 25.

Some measures may have a positive impact on some ratios and a negative impact on others.

Figure 25 also shows that these measures can be classified in four different categories depending on the ratios they will most likely improve.

- Measures 1 to 4 (cost savings, re-pricing loans and "debts to clients" and extra non-interest income) aim primarily at restoring profitability (ROE and C/I ratios).
- Measure 5 (issue new capital) aims to strengthen the capital position (CET1 ratio) and reduce leverage (i.e. increase leverage ratio), but will have the indirect impact of reducing the return on equity (ROE).
- Measure 6 (liquidity transformation of assets) aims at improving LCR by increasing the proportion of liquid assets in the investment portfolio. This measure implies, however, that a liquidity premium is foregone and so the return on equity is negatively impacted.
- Measure 7 (attracting more stable funding) aims to improve LCR (i.e. reduction of net stressed cash outflows) and NSFR (increase of available stable funding) by attracting more stable deposits. This measure, however, will have a negative impact on the other ratios.

Figure 25 : Options for intervention and their impact on the ratios

Management actions	Impact of management actions on ratios (*)					
	CET1 ratio	Leverage	LCR	NSFR	ROE	C/I
Cost savings (modelled as structural lowering in costs achieved in year 1 of projection)	+	+	+	+	++	++
Repricing loans (modelled as an annual basis point increase in interest revenues on X percentage of loans)	+	+	+	+	++	++
Repricing "debts to clients" (modelled as an annual basis point decrease in interest costs on X percentage of funds entrusted)	+	+	+	+	++	++
Generate extra non-interest income (modelled as an annual %-increase in non-interest income)	+	+	+	+	++	++
Issue new capital (modelled as an annual increase in capital which is held as liquidity)	++	++	+	+	--	+
Liquidity transformation of assets (modelled as not highly liquid assets being transformed into L1 HQLA, thereby foregoing a liquidity premium)	+/-	+/-	++	+	-	-
Attracting more stable funding (modelled as transfer from less stable deposits to more stable ones, implying cost of funding replacement)	-	-	+	+	-	-

(*) Assumption: management actions are not affected by the market or authorities.

Cost savings

This first measure consists of a structural net cost reduction achieved in year 1 of the projection. Note that the model doesn't take into account inflation meaning that the "cost of effort" is underestimated.

Re-pricing loans

In addition to cutting back costs, banks may decide to re-price loans in the long term to absorb the increase in costs. The re-pricing of loans is modelled as an annual basis point increase in interest revenues applied on 10% of loans[39] (representative of new production), all other things remaining equal.

Re-pricing "debts to clients"

In parallel with re-pricing loans, banks may opt for a progressive re-pricing of "debts to clients". This measure is modelled as an annual basis point decrease in interest costs applied on 30% of "debts to clients"[40].

Generate extra non-interest income

Banks also could attempt to earn addition non-interest income. This generation is modelled as an annual percentage increase of non-interest income (including fees and commissions).

Issuing new capital

Although issuing new capital is a possible action in order to strengthen the capital position and reduce leverage, it has not been considered in the most likely package of measures for the following reasons.

- Issuing new capital has an indirect negative short-term impact on return on equity, which is already the bottleneck for the Belgian sector.
- Given the relatively poor performance of the financial sector in recent years and the degree of uncertainty among investors about the business model of banks in view of all the pending changes, appetite from investors is expected to be low and capital issuance only possible at high costs.

Liquidity transformation of assets

This measure would consist of adapting the nature of the investment portfolio to improve the LCR. The measure is modelled by a yearly transfer of a certain amount from non-liquid assets to liquid assets. It is further assumed that this transfer generates an opportunity cost (~2%) on the investment portfolio as liquid assets are expected to generate lower returns.

Attracting more stable funding

The last measure considered plausible and which aims at increasing the liquidity ratios is modelled as a transfer from less stable deposits to more stable ones. This measure is also expected to have a negative impact on profitability ratios as more stable deposits are expected to generate higher funding costs for the banks.

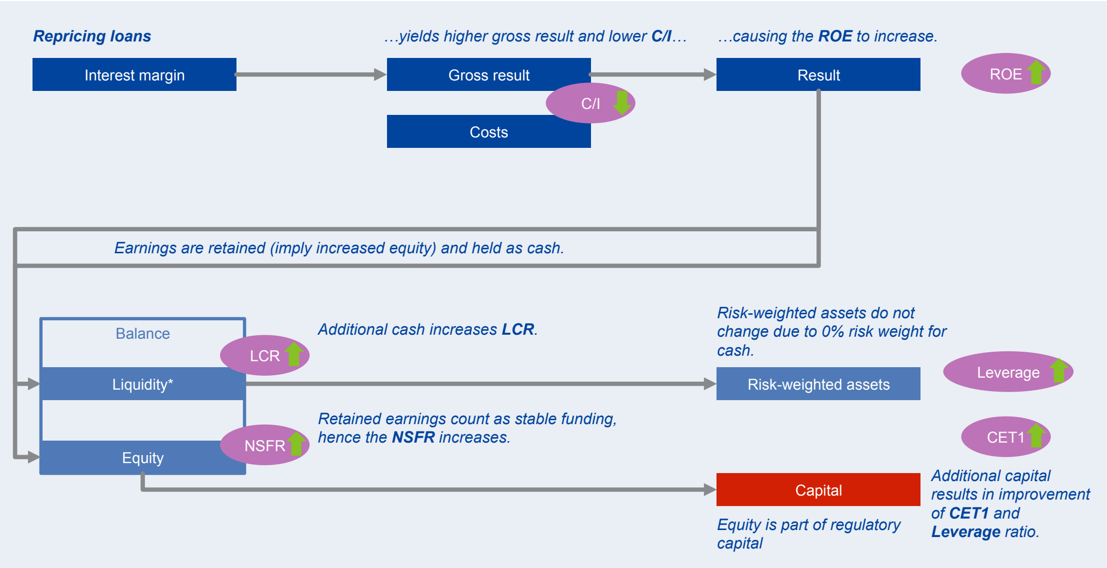
4.4.2 Impact of possible management actions on Basel III and profitability ratios

Because the anticipated actions have consequences for both the balance sheet and profitability, every measure would have an impact on all the ratios to some degree, be it positive and/or negative.

Figure 26 (on following page) illustrates this with the example of "repricing loans" as the management action. "Repricing loans" allows generation of an extra interest income and consequently improves the interest rate margin. The gross result would thus be higher, leading to a lower cost/income ratio and a higher return on equity. It is further considered that part of earnings are retained and held as cash, thus causing the liquidity coverage ratio to be improved given the higher amount of high-quality liquid assets. The Net Stable Funding Ratio will also increase since the retained earnings count as stable funding. Finally, retained earnings also would have a positive impact on the amount of regulatory capital, meaning that both CET1 and the leverage ratio are improved.

[39] This implies that 40% of the loan portfolio is re-priced by 2016 (10% per year during 4 years).
[40] This implies that 100% of the « due to clients » is re-priced by 2016 (30% per year during 4 years with a cap at 100%).

Figure 26 : Impact of re-pricing loans on the ratios



(*) The acquired liquidity generates interest income resulting in a change of the interest margin. Hence, it results in a second-order effect on all depicted variables. For the sake of simplicity, such effects have not been visualised in the above figure.

4.5 Anticipated mix of measures required to meet the target ratios

Each bank will of course determine the measures that it deems best suited to address its own challenges, in a competitive environment. That being said, the political world, rules-setting bodies and bank customers should understand that there are only a limited number of measures that banks can adopt. KPMG has analyzed three potential scenarios.

4.5.1 Definition of scenarios

The base case scenario shows that the Belgian banking sector will not meet the minimum requirements or the target ratios by year-end 2016 if no measures are taken. Profitability will be seriously affected by all regulations and seems unsustainable in the longer term.

Based on the possible actions presented in section 4.4, KPMG believes that banks are most likely to choose some combination of the actions that support return on equity and cost/income ratio, i.e. cost cutting, re-pricing loans, re-pricing "debts to clients" and extra non-interest income generation.

Furthermore, as the minimum level of 100% LCR is not reached in 2013 in the base case scenario, "transformation of assets" is likely to also figure in the mix of actions, despite the negative effect it can have on ROE and C/I ratios.

Based on the above remarks, KPMG believes that the most plausible scenario is that measures will be combined (which would result in the costs being shared between banks, shareholders and clients) in order to reach the target levels by 2016.

Given the relatively important gap between the ROE of the sample at the end of 2016 (3.8%) and the target ROE at end of 2016 (8%), a variant of scenario 1, in which the objective is no longer to reach a profitability of 8% by 2016 but only to restore profitability to the 2012 levels (ROE of ~5.9%), has also been analyzed. This scenario would lead to an outcome that, from an overall point of view, is less than ideal, as a higher return on equity is necessary not only to ensure equity market access, but also to keep up with innovation and its ability to support economic growth.

Finally, a third scenario has been analyzed to show that concentrating all the efforts on only one measure is not a realistic option if the goal is to reach the target levels by 2016. This is further illustrated with cost cutting or re-pricing as the sole management action.

4.5.2 Scenario 1

Under scenario 1, the objective would be to reach a profitability of at least 8% by the end of 2016 by combining measures that affect banks, shareholders and clients.

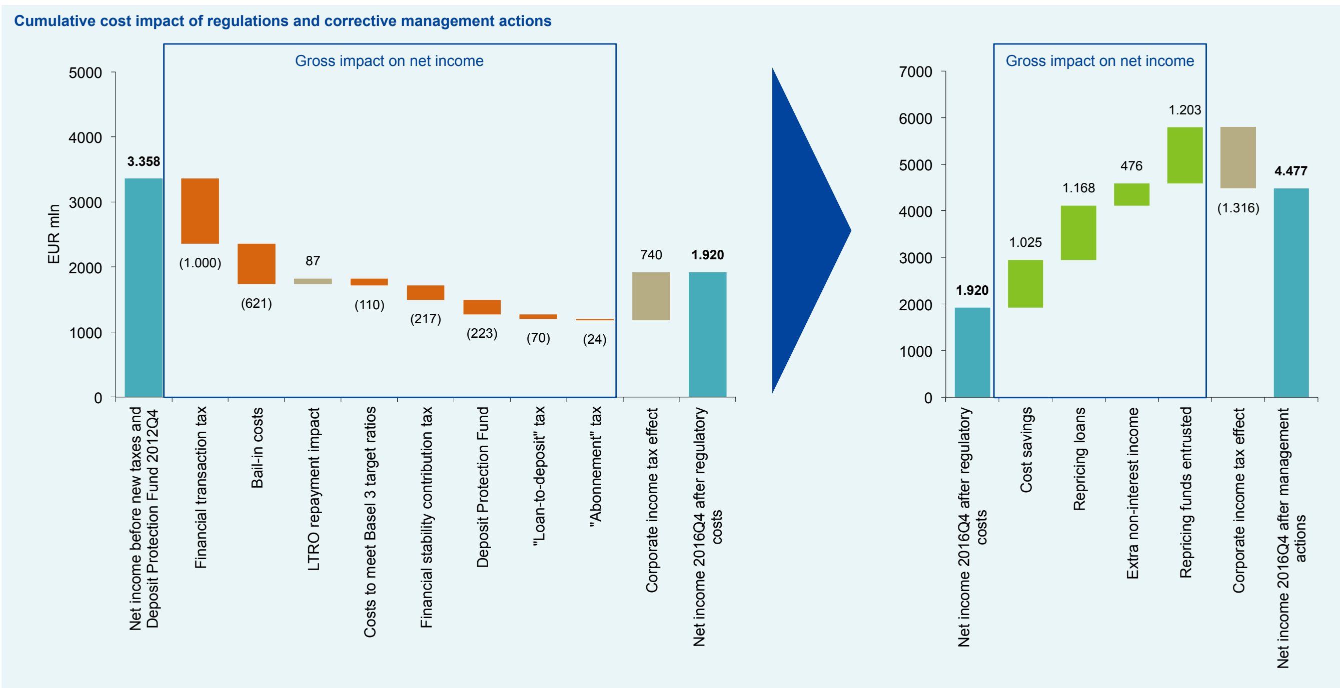
This mix of measures would include[41]:

- a structural net cost reduction of 10% achieved in year 1;
- extra non-interest income (fee business) generated at a rate of 2.5% per year;
- re-pricing of "debts to clients" by 25 basis points (assuming 30% of the portfolio is re-priced each year);
- re-pricing of loans by 70 basis points (assuming 10% of the portfolio is re-priced each year); and
- a "liquidity transformation of assets" (from non-liquid to liquid assets) for an amount of EUR 5.5 billion applied in 2013.

The cumulative effect of the regulations and above measures is illustrated in Figure 27 . The table on the left illustrates the effects on profitability of Financial Transaction Tax, bail-in, DGS and other bank contributions. The table on the right illustrates the result that the measures subsequently achieve.

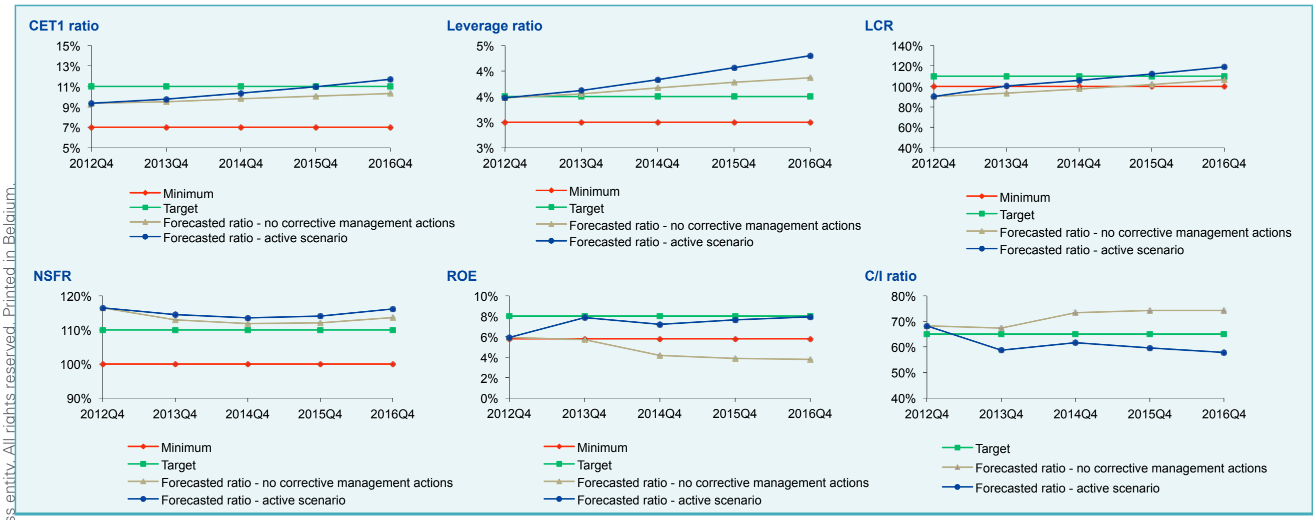
Then Figure 28 (on the following page) illustrates the evolution of Basel III and profitability ratios respectively, both with management actions (blue line) and without management actions (grey line). The asset transformation carried out in 2013 allows the LCR to reach the 100% target by end of 2013. Other management actions contribute generating extra income and result in higher profitability and buffers. All target ratios are reached by the end of 2016.

Figure 27 : Increasing profitability under scenario 1



[41] Clearly this is not the only possible combination but one that seemed realistic to our sounding boards (KPMG).

Figure 28 : Evolution of Basel III and profitability ratios under scenario 1



Note that without taking into account the impact of FTT, the mix of actions could be adapted as follows:

- a structural net cost reduction of 8% (instead of 10%) achieved in year 1;
- extra non-interest income (fee business) generated at a rate of 2% (instead of 2.5%) per year;
- re-pricing of "debts to clients" by 15 basis points (instead of 25 basis points) (assuming 30% of the portfolio is re-priced each year);
- re-pricing of loans by 60 basis points (instead of 70 basis points) (assuming 10% of the portfolio is re-priced each year); and
- a "liquidity transformation of assets" (from non-liquid to liquid assets) for an amount of EUR 5.5 billion applied in 2013 (unchanged).

4.5.3 Scenario 2

Under scenario 2, the objective would no longer be to reach a profitability of 8% by 2016 but only to restore profitability to 2012 levels (ROE of ~5.9%). As mentioned, this scenario would seem less preferable from an overall point of view since a higher return on equity serves the interests of all stakeholders. A possible mix of management actions under scenario 2 includes:

- a structural net cost reduction of 6% achieved in year 1;
- re-pricing of "debts to clients" by 10 basis points (assuming 30% of portfolio is re-priced per year);
- re-pricing of loans by 50 basis points (assuming 10% of portfolio is re-priced per year); and
- a "liquidity transformation of assets" (from non-liquid to liquid assets) for an amount of EUR 5.5 billion applied in 2013.

In comparison with scenario 1, cost savings would be reduced (6% instead of 10%), while generation of extra non-interest income would be excluded from the mix of actions. Re-pricing of "debts to clients" and loans has been continued but with slightly lower impacts (10 basis points compared to 25 basis points for re-pricing of «debts to clients», 50 basis points compared to 70 basis points for re-pricing of loans). The cumulative effect of the regulations and bank actions is illustrated in Figure 29.

Figure 29 : Restoring profitability under scenario 2

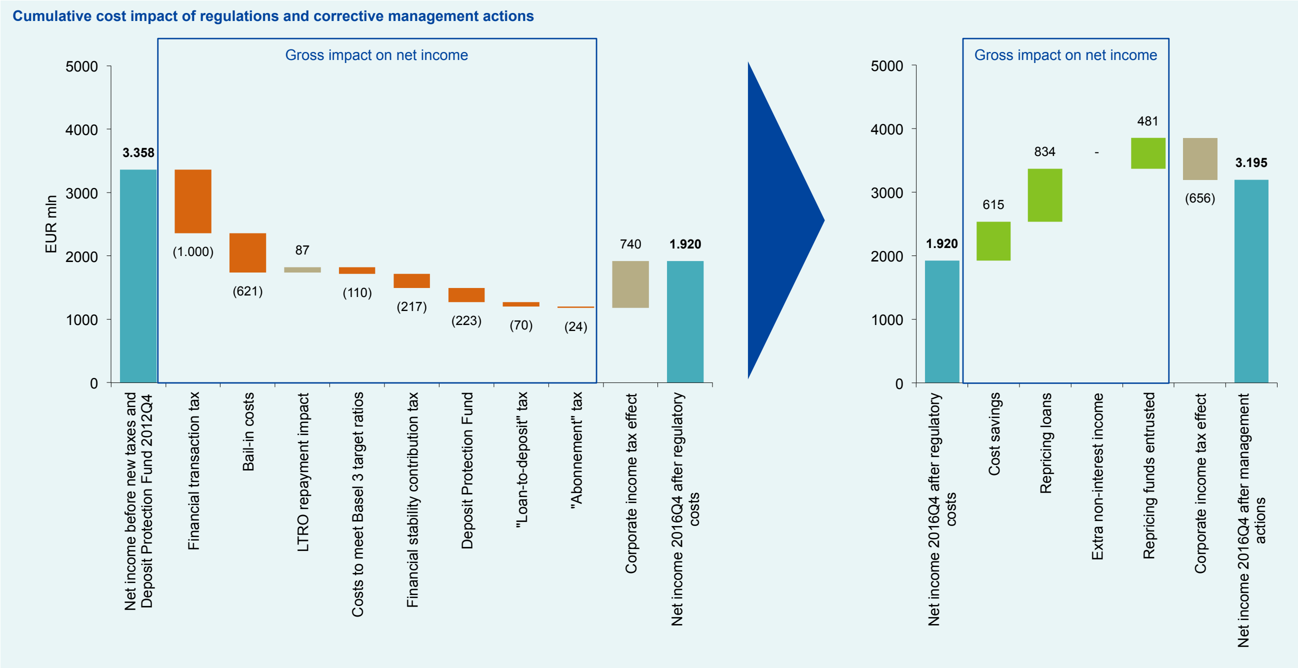
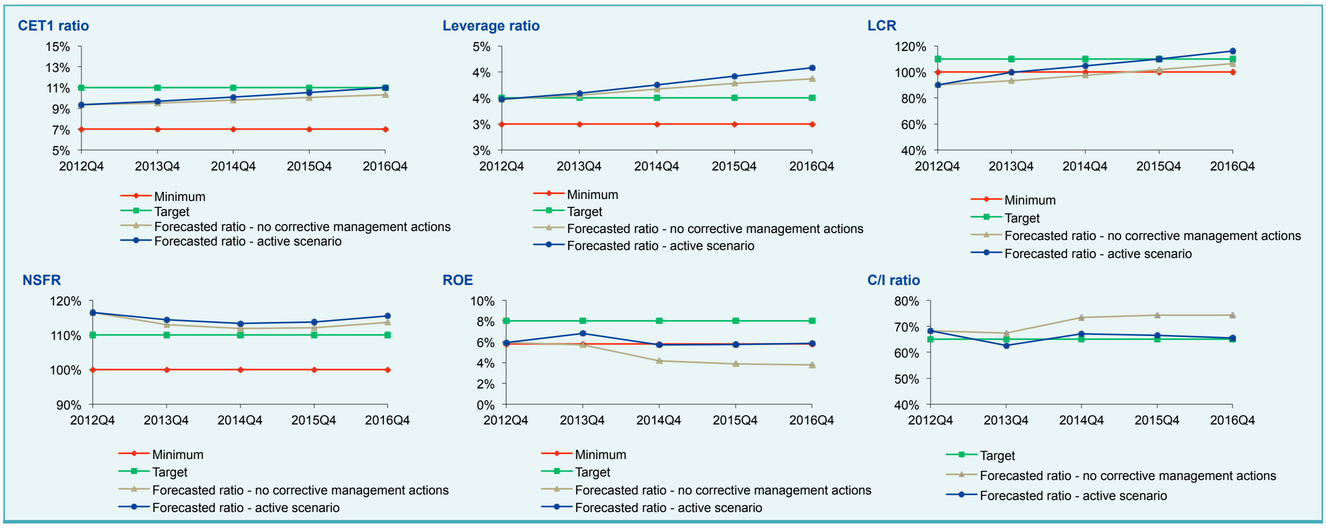


Figure 30 illustrates the evolution of Basel III and profitability ratios both with management actions (blue line) and without management actions (grey line).

Figure 30 : Evolution of Basel III and profitability ratios under scenario 2



4.5.4 Scenario 3

In the third scenario, the objective would again be to reach a profitability of minimum 8% by the end of 2016. However, in this scenario all the efforts would be concentrated on only one management action. The results of the quantitative analysis indicate that if only cost cutting or only re-pricing is considered as the sole management action, the effort that would be needed is:

- a structural net cost reduction of 40% achieved in year 1; or
- re-pricing of loans by 230 basis points (10% of portfolio is re-priced each year).

KPMG believes that these figures demonstrate that concentrating all the efforts on only one management action is not a plausible option if the goal is to reach target levels by 2016. On the basis of these numbers, this scenario would not seem sustainable and would have irremediable consequences for all stakeholders.

4.6 Comparison with the Netherlands

The KPMG network in the Netherlands ('KPMG Netherlands') conducted a similar study in 2012.

Figure 31 shows that, in the situation sketched on following page, the Dutch banking sector will not meet the expected minimum requirements or the target ratios at year-end 2015. Similar to Belgium, the figure shows that profitability is a) seriously affected by all regulations and b) unsustainable without taking appropriate measures. Moreover, without intervention, the target ratios will not be achieved in 2015 – except for the leverage ratio. Additional measures are therefore essential as well.

Based on discussions KPMG Netherlands had with the Dutch banking sector, and other insights, a series of possible management measures was considered.

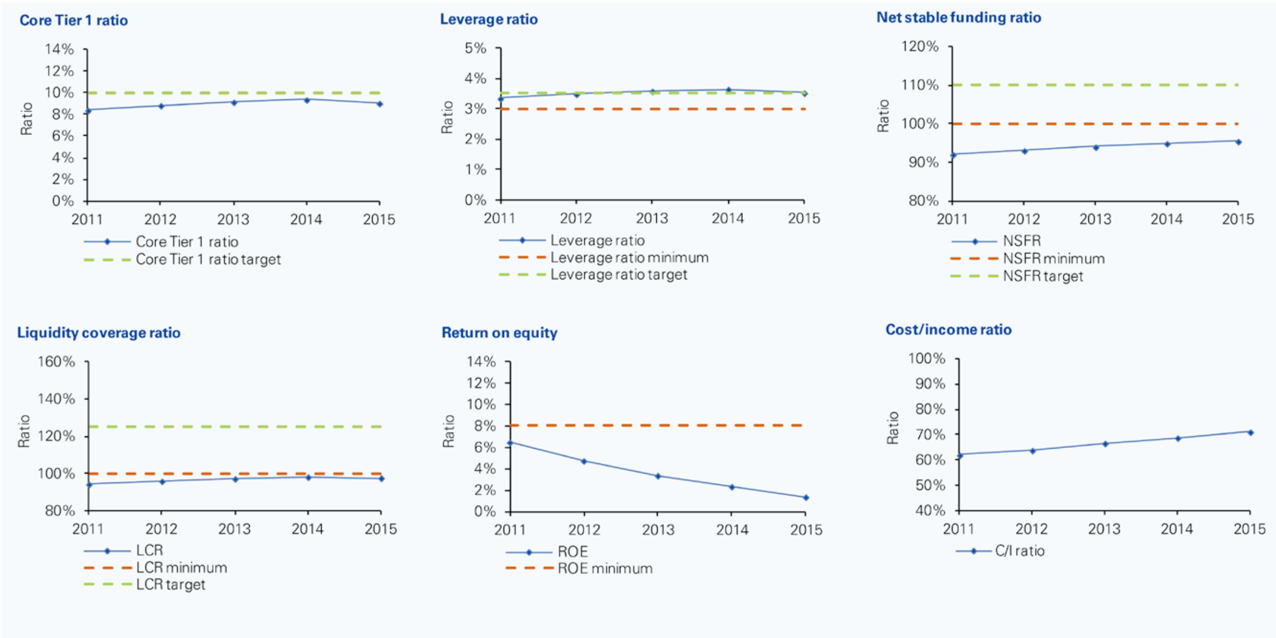
- Structural 5% net reduction in costs.
- Attracting a cumulative ~EUR 50 billion in long-term funding to replace short-term funding.
- Cumulative net balance sheet reduction of ~EUR 200 billion (excluding liquid assets).
- Average re-pricing by 80-90 basis points, assuming a portfolio of ~20% of total assets (excl. liquid assets) is re-priced annually.

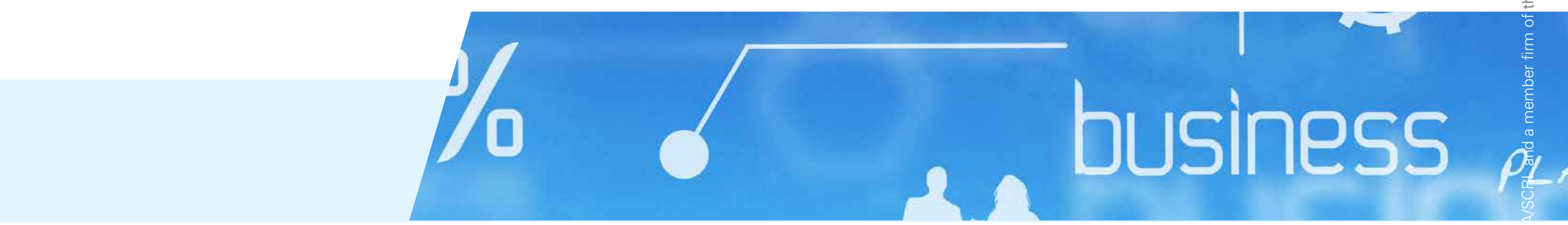
With this package of measures, targets for the Common equity Tier 1 ratio, leverage ratio, LCR, NSFR and ROE will be achieved by end 2015.

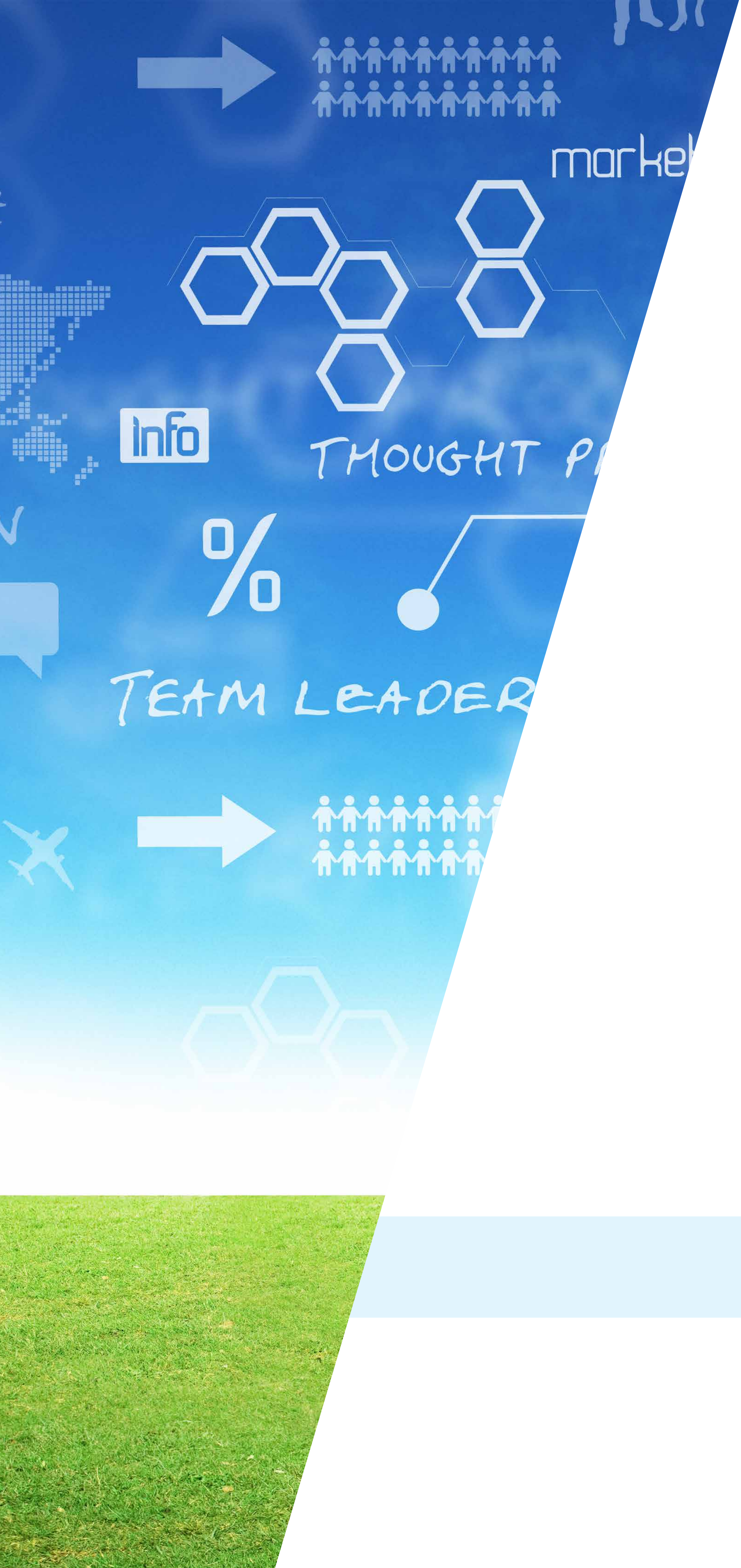
Within the Basel III measures, the scope of the actions is primarily determined by the NSFR, which is unlikely to be the case for Belgium. In the analysis, this ratio requires the biggest effort by the Dutch banking sector because major adjustments to the balance sheet composition are required for the NSFR to increase by even one percentage point[42].

[42] For more information see : The cumulative impact of regulation - An analysis of the effects of the increase in and accumulation of regulations on the services provided by the Dutch banking sector, KPMG, September 2012

Figure 31 : Impact of regulations on financial ratios under base case scenario for Dutch banking sector (KPMG study, 2012)






Info

5. Conclusion

In this study we explained that Banks have to cope with a multitude of new global, regional and national rules and have to respond to a wide spectrum of new requirements, from capital and liquidity requirements to corporate governance, from derivatives to the design of retail products, and from resolution to remuneration. These new regulations have a significant impact on the way in which banks can continue to fulfil their core function.

KPMG conducted a study in two steps:

1. A qualitative survey whereby participating banks were asked to provide us with their views on the impacts of 31 regulations; and
2. A quantitative analysis on the cumulative effect of the four rules expected to have the largest impact on the financial situation of banks and of which the impact is sufficiently quantifiable.

In our qualitative survey (section 3), we looked at different domains of impact. On this basis, we conclude that many regulations are not only a question of compliance but have significant impacts on the financial situation (balance sheet and income statement), on the business model, on the operating model and on the change capacity of banks. The regulatory reform agenda is perhaps the biggest driver of strategic and operational change – managing this is a key challenge for the entire industry.

In our quantitative analysis (section 4) we assessed the direct impact over the horizon 2013-2016 of four regulations:

- CRD IV/Basel III
- Deposit Guarantee Scheme and other Bank Contributions (Stability contribution, "Loan-to-deposit" tax, "Abonnement" tax)
- Financial Transaction Tax
- Bail-in debt (crisis management framework)

We found that (even only) those four regulations (will) have a serious impact on the profitability of Belgian banks, now and in the future.

Each bank will of course determine the measures that it deems best suited to address its own challenges in a competitive environment. We believe however that generally speaking the Belgian banks are most likely to choose for a combination of actions that will mainly support their return on equity and cost/income ratio, i.e. cost cutting, re-pricing loans, re-pricing "debts to clients" and extra non-interest income generation.


VISUAL RESPONSE
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Appendix A – Description of recent and pending regulations

Category 1 - Consumer Issues

In the category of consumer issues, the regulations refer to payment services and to retail financial services. Initiatives in these focus areas aim at increasing consumer protection and overall transparency.

- ### *Sub-category 1.1 - Payment Services*

  Payments are the "oil in the wheels of the Internal Market". It is of major importance that those wheels run smoothly. The objective is a ***Single Euro Payments Area*** (SEPA), in which citizens and businesses can make cross-border payments as easily, safely and efficiently as they can within their own countries and subject to identical charges. The SEPA project, which is an initiative of the European banking industry, is strongly supported by the European Commission and the European Central Bank.

  Focus Area 1: Payment Services Directive
  The Payment Services Directive (PSD)[43] provides the necessary legal framework for SEPA, as well as for better payments in all EU countries. The PSD aims at establishing a modern and comprehensive set of rules applicable to all payment services in the European Union. The target is to make cross-border payments as easy, efficient and secure as 'national' payments within a Member State. The PSD also seeks to improve competition by opening up payment markets to new entrants, thus fostering greater efficiency and cost-reduction. The directive went into effect in 2009 and has been implemented under Belgian legislation through various laws and royal decrees over the period of 2009-2011.

  Focus Area 2: Electronic Money Directive (EMD)
  The new E-Money Directive (EMD)[44] focuses on modernising EU rules on electronic money, especially bringing the prudential regime for electronic money institutions, into line with the requirements for payment institutions in the Payment Services Directive. The rules in the E-Money Directive went into effect in 2011 and were implemented under Belgian law in 2012[45].

  PSD and EMD are intented for the benefit of consumers, businesses and the wider European economy.

- ### *Sub-category 1.2 - Retail Financial Services*

  Retail financial services play a major role in the everyday life of European Union citizens. In spite of the significant progress that has been made in recent years, both in terms of consumer protection and of integration, further efforts are still needed.

  Focus Area 3: Consumer Credit
  Regarding the recent progress achieved, it is worth mentioning the ***new Directive on Credit Agreements for Consumers***[46], which focuses on transparency and consumer rights. It provides comprehensive information intended for consumers that should be provided before the contract is concluded and as part of the credit agreement. In order to enhance the ability of consumers to compare the different offers and to make the information more understandable, the pre-contractual information needs to be supplied in a standardised form (Standard European Consumer Credit Information). In addition, the Directive foresees two essential rights for consumers: withdrawal within a period of 14 days after the conclusion of the contract and the right to early repayment of their credit at any time. This directive has been transposed under Belgian law by the Act of 13 June 2010 amending the Consumer Credit Act of 12 June 1991.

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[43] 2007/64/EC
[44] 2009/110/EC
[45] Belgian Law of 27/11/2012
[46] 2008/48/EC

More recently, the ***Directive on Consumer Rights***[47], which was published on 22 November 2011, aims to achieve a real business-to-consumer (B2C) internal market, striking the right balance between a high level of consumer protection and the competitiveness of enterprises. This new directive brings 10 major changes (e.g. protection against hidden charges and costs, increased price transparency, 14 days to change your mind on a purchase, etc.) for consumers. These changes will give them stronger rights when they shop online. The new rules of the directive are expected to be transposed into the national laws by end 2013 and be applied in all Member States by June 2014 at the latest.

Focus Area 4: Mortgage Credit

The EU Commission also submitted a ***proposal of mortgage credit directive***[48] in March 2011. It aims to offer a higher level of protection to borrowers through robust rules concerning advertising, pre-contractual information, advice, creditworthiness assessment, and early repayment. In addition, the requirement to provide personalised information to the consumer through a European Standardised Information Sheet will allow consumers to compare mortgage conditions from different providers. The proposed Directive also aims to create a more efficient and competitive single market for mortgages by creating a level playing field for all actors involved and facilitating cross-border activity.

The first draft of the proposed directive was published in March 2011 and it has been the subject of long-standing negotiations and consultation across Europe. An agreement on a revised directive was reached in April 2013. To take effect, the new rules must be approved by the EU parliament and endorsed by the member states. A plenary vote will be held in the EU parliament in June 2013.

Focus Area 5: Packaged Retail Investment Products (PRIPs)

On 3 July 2012 the European Commission presented their ***legislative proposal*** for a regulation on key informational documents for ***packaged retail investment products***[49] (PRIPs). The PRIPs proposal aims to improve transparency in the investment market for retail investors. According to this proposal, consumers will be informed in an easy to understand, short and standardized format called the "Key Information Document" (KID). With this proposal, the Commission seeks to help retail investors to make a more informed decision on whether or not an investment is right for them and allow them to effectively compare investment products. In addition to this, the proposal aims to ensure a level playing field between the different investment product manufacturers and the entities that sell such products. The proposal takes the form of a Regulation and will therefore not require implementation into national law but will be directly applicable in all Member States shortly after it is adopted. The Commission expects the final Regulation to be in place by the end of 2014.

Category 2 - Financial institutions

- ### *Sub-category 2.1 - Corporate governance and remuneration policies*

Focus Area 6: Remuneration Policies

During the last decade, a number of mis-selling scandals have affected retail investors across Europe, ranging from pensions to mortgages to investment products. A key factor, identified as a driver for the promotion, recommendation and selling of unsuitable products, was the financial incentive schemes for sales staff that did not take into account the clients' best interests.

To avoid such practices in the future, to strengthen investor protection and to achieve the same level of protection across Europe, a number of initiatives have been taken at the European level. Several ***guidelines on remuneration policies***[50] have thus been published over the last 2 years by CEBS and EBA. These guidelines have been further implemented by NBB through several ***circulars***[51].

[47] 2011/83/EU
[48] COM(2011)142
[49] COM(2012) 352
[50] CEBS Guidelines on Remuneration Policies and Practices, EBA guidelines on the Remuneration Benchmarking Exercise (EBA/GL/2012/4) and EBA guidelines on the Data Collection Exercise Regarding High Earners (EBA/GL/2012/5)
[51] Circulars NBB-2011-05, NBB-2012-09 and NBB-2012-10

Furthermore, in September 2012, ESMA published a ***consultation paper on proposed Guidelines on remuneration policies and practices under the Markets in Financial Instruments Directive (MiFID)***[52]. These guidelines are key to ensuring that the pay structure and incentive structure for sales staff and their superiors do not create false incentives when selling financial products to retail investors.

The key elements of the guidelines include obligations from the firms to

(i) ensure that remuneration is not paid in a manner that aims to circumvent the MiFID requirements and/or the ESMA guidelines,

(ii) design and monitor the remuneration policies and practices to take into account the manner in which the business is conducted and potential conflicts of interest risks that may arise, and

(iii) establish adequate controls for the implementation of their remuneration policies and practices to ensure that they deliver the intended outcomes.

The final report and the final guidelines are expected for the second quarter of 2013.

Finally, in the framework of the CRD IV package[53], a step has been taken to limit excessive bonuses in the banking sector. According to the deal reached by the European Parliament and Council negotiators in March 2013, Bankers' annual bonuses must not normally exceed their annual salaries. The political agreement was approved in European Parliament plenary session in April 2013. Member states need now to include the rules in their national laws by 1 January 2014.

Focus Area 7: Corporate Governance

Corporate governance defines relationships between a company's management, its board, its shareholders and its other stakeholders. It determines the way companies are managed and controlled. An effective corporate governance framework is crucial because well-run companies are likely to be more competitive and more sustainable in the long term.

The EU corporate governance framework is a combination of legislation and soft law, namely national corporate governance codes applied on a 'comply' or 'explain' basis which gives companies and their shareholders an important degree of flexibility.

In Belgium, a number of initiatives have been taken over the last few years by the NBB and the FSMA[54] in the field of corporate governance. It is worth mentioning the circular issued by the CBFA in 2007 that specified ***prudential expectations regarding financial institutions corporate governance***[55]. More recently, the NBB and the FSMA published a ***joint circular on the compliance function***[56], implementing the European Securities and Markets Authority (ESMA) ***orientations on that function and on the suitability test***[57]. In particular, a number of principles have been developed in regards to: the role of the compliance function within these institutions, the organization thereof and its specific tasks. The grounding principle is that this function must be independent and it must be able to report to the institution's senior management and management boards.

Focus Area 8: Corporate Governance and Remuneration Policies

In order to respond rapidly to the problem of excessive risk-taking in credit institutions and ultimately the accumulation of excessive risk in the financial system, in 2010 the Commission launched a ***Green Paper on corporate governance in financial institutions and remuneration policies***[58] and, in 2011, it proposed stricter rules on corporate governance in financial institutions in the framework of the CRD IV package[59].

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52 ESMA/2012/570
53 COM(2011) 453 final and COM(2011) 452 final
54 Previously CBFA (Commision Bancaire Financière et des Assurances)
55 Circular PPB-2007-6-CPB-CPA
56 Circulars NBB-2012-14 & FSMA-2012-21
57 ESMA/2012/387 & ESMA/2012/388
58 COM(2010) 284 final
59 COM(2011) 453 final and COM(2011) 452 final

- *Sub-category 2.2 - Banking*

Focus Area 9: CRDIV / Basel III

EU rules regarding capital requirements for credit institutions and investment firms aim to put in place a comprehensive and risk-sensitive framework and to foster enhanced risk management amongst financial institutions.

We briefly outline below, the evolution of the legal framework for capital requirements starting in 2006 with first legislative package (CRD I) and ending today with the new proposals for capital requirements (CRD IV Package).

CRD I - First legislative package

In 2000, seven Banking Directives and their amending Directives were replaced by one single Banking Directive[60], which aimed to improve the clarity and transparency of the EU legislation and to create a kind of "European Banking Act". The adoption of the Basel II guidelines in 2004 was followed at the EU level by a recasting of the Banking Directive[61] on the one hand and the Capital Adequacy Directive[62] on the other hand. These two Directives were officially adopted on 14 June 2006 (IP/06/797) and published in the Official Journal on 30 June 2006. Both Directives put in force on 20 July 2006.

CRD II

On 16 September 2009, the Council and the European Parliament officially adopted 3 directives[64], which were part of the second legislative package aimed at ensuring the financial soundness of banks and investment firms. The main amendments introduced aimed at improving the management of large exposures, the quality of banks' capital, the liquidity risk management and the risk management for securitised products. The 'supervisory colleges' were established for banking groups that operate in multiple EU countries. These amendments formed part of the Commission's response to the financial crisis by strengthening the regulatory framework in the areas relevant to the causes of the crisis. The adjustments needed to be transposed in national law by 31 October 2010.

CRD III

On 24 November 2010, the Council and the European Parliament officially adopted a new directive on capital requirements[64] for the trading book, and for the re-securitisations and supervisory review of remuneration policies. This directive was to be implemented in two phases. The first, which affects the remuneration provisions, as well as a number of provisions dealing with the extension of pre-existing minimum capital requirements, had to be implemented by 1 January 2011. The remaining provisions had to be implemented by 31 December 2011.

CRD IV package - new proposals on capital requirements

On 20 July 2011, the Commission adopted a legislative package to strengthen the regulation of the banking sector. The proposals replace the current Capital Requirements Directives[65] with a ***Directive***[66] and a ***Regulation***[67] and constitute another major step towards creating a sounder and safer financial system.

The Commission's proposals have ***three concrete goals***.

- o The proposals will require banks to hold more and better capital to resist future shocks by themselves. Institutions entered the last crisis with capital that was insufficient both in quantity and in quality, leading to unprecedented need for support from national authorities. With its proposals, the Commission translates for the European level the international standards for bank capital agreed upon at the G20 level (most commonly known as the ***Basel III agreement***).

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60 Directive 2000/12/EC
61 Directive 2006/48/EC
62 Directive 2006/49/EC
63 Directives 2009/111/EC, 2009/27/EC and 2009/83/EC
64 Directive 2010/76/EU
65 Directives 2006/48/EC and 2006/49/EC
66 COM(2011) 453 final
67 COM(2011) 452 final

- The Commission also wants to set up a new governance framework giving supervisors new powers to monitor banks more closely and take action through potential sanctions.
- By putting together all legislations applicable to this matter, the Commission proposes having a ***Single Rule Book*** for banking regulation. This will improve both transparency and rule enforcement.

The proposals contain two parts: a directive governing access to deposit-taking activities and a regulation governing how activities are carried out by credit institutions and investment .

The ***Regulation*** contains the detailed prudential requirements for credit institutions and investment firms, and it covers:

- Capital: The Commission's proposal increases the amount of own funds banks need to hold as well as the quality of those funds. It also harmonises the deductions from own funds in order to determine the amount of regulatory capital that is prudent to recognise for regulatory purposes.
- Liquidity: To improve short-term resilience of the liquidity risk profile of financial institutions, the Commission proposes the introduction of a Liquidity Coverage Ratio (LCR) - the exact composition and calibration of which will be determined in 2015 after an observation and review period.
- Leverage ratio: In order to limit an excessive build-up of leverage on credit institutions' and investment firms' balance sheets, the Commission also proposes that a leverage ratio be subject to supervisory review. Implications of a leverage ratio will be closely monitored prior to a possible move to turn it into a binding requirement on 1 January 2018.
- Counter party credit risk: changes are made to encourage banks to clear OTC derivatives on CCPs (central counterparties).
- Single rule book: the financial crisis highlighted the danger of divergent national rules. A single market needs a single rule book. The Regulation is directly applicable without the need for national transposition and accordingly eliminates one source of divergence. The Regulation also sets a single set of capital rules.

The new ***Directive*** covers areas of the current Capital Requirements Directive where EU provisions need to be transposed by Member States in a way suitable to their own environment, such as the requirements for access to the taking up and pursuit of the business of banks, the conditions for their exercise of the freedom of establishment and the freedom to provide services, and the definition of competent authorities and the principles governing prudential supervision.

New elements in this directive are:

- Enhanced governance: the proposal strengthens the required corporate governance arrangements and processes and introduces new rules aimed at increasing the effectiveness of risk oversight by boards, improving the status of the risk management function and ensuring effective monitoring by supervisors of risk governance.
- Sanctions: If institutions breach EU requirements, the proposal will ensure that all supervisors can apply sanctions that are truly dissuasive, but also effective and proportionate - for example administrative fines of up to 10% of an institution's annual turnover, or temporary bans on members of the institution's management body.

- o Capital buffers: it introduces two capital buffers in addition to the minimum capital requirements: a capital conservation buffer identical for all banks in the EU and a countercyclical capital buffer to be determined at a national level.
- o Enhanced supervision: the Commission proposes a reinforced supervisory regime, that will require the annual preparation of a supervisory programme for each supervised institution on the basis of the following: a comprehensive risk assessment, greater and more systematic use of on-site supervisory examinations, more robust standards and more intrusive and forward-looking supervisory assessments

Finally, the proposals will seek to reduce, to the extent possible, the reliance of credit institutions on external credit ratings by: a) requiring that all banks' investment decisions are based not only on ratings but also on their own internal credit opinion, and b) that banks with a material number of exposures in a given portfolio develop internal ratings for that portfolio instead of relying on external ratings for the calculation of their capital requirements.

This new legislative package constitutes another major step towards creating a sounder and safer European financial system.

Focus Area 10: Deposit Guarantee Schemes (DGS) and Bank Contributions

Deposit Guarantee Schemes reimburse a limited amount of deposits to depositors whose bank has failed. From the depositors' point of view, this protects a part of their wealth from bank failures. From a financial stability perspective, this prevents depositors from making panic withdrawals from their bank, thereby preventing severe economic consequences.

The intervention principles of the deposit protection system are based on the provisions of the ***Directive 94/19/EC*** of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes and have been implemented under Belgian legislation by the law of 23 March 1993 related to control of credit institutions and the law of 6 April 1995 related to the control of investment firms. The financing of the Belgian deposit protection system is done through annual contributions paid by the financial institutions participating in the deposit guarantee.

In the wake of the 2008 financial crisis, some emergency measures were taken at the European level and later introduced by the Directive ***2009/14/EC***. On 12 July 2010, the European Commission adopted a ***legislative proposal***[68] for a thorough revision of this Directive. It deals mainly with a harmonisation and simplification of protected deposits, a faster payout, and an improved financing of schemes. For bank-account holders, the measures mean that in the case of a bank failure, they would get their money back more quickly (within seven days), receive increased coverage (up to €100 000) and be privy to better information on how and when they are protected. For investors who use investment services, the Commission proposes speedier compensation if an investment firm fails to return the investor's assets due to fraud, administrative malpractice or operational errors. In addition, the level of compensation will increase from €20 000 to €50 000. Investors will also receive more information on when the compensation scheme would apply and get better protection against fraudulent misappropriations where their assets are held by a third party. The proposals have now passed to the European Parliament and the Council of Ministers for consideration.

At the Belgian level, the deposit protection amount was increased to €100,000 with the Royal Decree of 14 November 2008. Furthermore, the annual contributions to be paid by the financial institutions participating in the deposit guarantee scheme were revised in 2011 and a new risk based contribution to the fund was introduced that depends on the individual risk profile.

In the same year, two new annual bank levies were introduced. The first was introduced as a new financial stability contribution, which applies to all banks established in Belgium and amounts to 3.5 basis points of the total amount of liabilities, minus equity and deposits that are subject to the guarantee scheme[69]. The second was introduced as an annual levy on credit

[68] COM(2010)369
[69] Law of 28 December 2011 and RD of 23 February 2012

institutions amounting to 5 basis points multiplied by a factor that depends on the amount of European loans not granted to financial institutions (60% - 240%)[70].

Focus Area 11: Crisis Management & Bank resolution

During the recent financial crisis, a number of governments had to take emergency actions to stabilise banks. Without this government intervention, several banks might have failed. The quick and effective intervention by national governments avoided this and prevented a serious financial meltdown. The unprecedented circumstances of the crisis justified such exceptional actions. However, governments acted under national law. There is currently no EU framework for managing crises in the banking sector, and the crisis has clearly shown that the lack of such an EU framework hampers the ability of governments to deal with problems relating to cross-border banks.

On 6 June 2012, the Commission adopted a ***legislative proposal for bank recovery and resolution***[71]. The proposed framework sets out the necessary steps and powers to ensure that bank failures across the EU are managed in such a way as to avoid financial instability and minimise costs for taxpayers. Thanks to this framework, authorities will be able to intervene decisively before problems occur or early on in the process. Furthermore, if the financial situation of a bank deteriorates beyond repair, the proposal ensures that a bank's critical functions can be rescued while the costs of restructuring and resolving failing banks fall on the bank's owners and creditors rather than on taxpayers. The proposal is likely to come into effect in 2015.

Key elements of the proposal

The proposed tools are divided into powers of "prevention", "early intervention" and "resolution", with intervention by the authorities becoming more intrusive as the situation deteriorates.

- Preparation and prevention

First, the framework requires banks to draw up ***recovery plans*** setting out measures that would come into play to restore their viability in the event that their financial situation deteriorates.

Second, authorities tasked with the responsibility of resolving banks are required to prepare ***resolution plan***s that provide options for dealing with banks that are in critical condition and no longer viable (options include details on the application of resolution tools and ways to ensure the continuity of critical functions). Recovery and resolution plans are to be prepared both at a group level and for the individual institutions within the group.

Third, if authorities identify obstacles to resolvability in the course of this planning process, they can require a bank to change its legal or operational structures to ensure that it can be resolved with the available tools in a way that does not compromise critical functions, threaten financial stability, or involve costs to the taxpayer.

Finally, financial groups may enter into intra-group support agreements to limit the development of a crisis and quickly boost the financial stability of the group as a whole. Subject to approval by the supervisory authorities and the shareholders of each entity that is party to the agreement, the institutions which operate in a group would thus be able to provide financial support (in the form of loans, the provision of guarantees, or the provision of assets for use as collateral in transactions) to the other entities within the group that experience financial difficulties.

- Early intervention

Early ***supervisory intervention*** will ensure that financial difficulties are addressed as soon as they arise. Early intervention powers are triggered when an institution does not meet or is likely to be in breach of regulatory capital requirements. Authorities could require the institution to implement any measures set out in the recovery plan, draw up an action programme and a timetable for its implementation, require the convening of a meeting of shareholders to adopt urgent decisions, and require the institution to draw up a plan for the restructuring of debt with its creditors.

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70 Royal Decree of 03 August 2012

71 COM(2012) 280

In addition, supervisors will have the power to appoint a special manager at a bank for a limited period when there is a significant deterioration in its financial situation and the tools described above are not sufficient to reverse the situation. The primary duty of a special manager is to restore the financial situation of the bank and the sound and prudent management of its business.

- Resolution powers and tools

Resolution takes place if the preventive and early intervention measures fail to redress the situation from deteriorating to the point where the bank fails or is likely to fail. If the authority determines that no alternative action would help prevent failure of the bank, and that the public interest (access to critical banking functions, financial stability, integrity of public finances, etc.) is at stake, authorities should take control of the institution and initiate ***decisive resolution action***.

The main resolution tools are the following:

- the ***sale of business tools*** whereby the authorities would sell all or part of the failing bank to another bank;
- the ***bridge institution too***l which consists of identifying the good assets or essential functions of the bank and separating them into a new bank (bridge bank) which would be sold to another entity. The old bank with the bad or non-essential functions would then be liquidated under normal insolvency proceedings;
- the ***asset separation tool*** whereby the bad assets of the bank are put into an asset management vehicle. This tool cleans the balance sheet of a bank. In order to prevent this tool from being used solely as a state aid measure, the framework prescribes that it may be used only in conjunction with another tool (bridge bank, sale of business or write-down). This ensures that while the bank receives support, it also undergoes restructuring; and
- the ***bail-in tool*** whereby the bank would be recapitalised with shareholders wiped out or their equity diluted, and creditors would have their claims reduced or converted to shares. An institution for which a private acquirer could not be found, or which could be complicated to split up, could thus continue to provide essential services without the need for bail-out by public funds, and authorities would have time to reorganise it or wind down parts of its business in an orderly manner. To this end, banks would be required to have a minimum percentage of their total liabilities in the shape of instruments eligible for bail-in. If triggered, they would be written down in a pre-defined order by seniority of claims in order for the institution to regain viability.

Cooperation between national authorities

In order to deal with EU banks or groups that operate across borders, the framework enhances cooperation between national authorities in all phases of preparation, intervention and resolution.

Resolution funding

To be effective, the resolution tools will require a certain amount of funding. If market funding is not available and in order to avoid resolution actions from being funded by the state, supplementary funding will be provided by resolution funds which will raise contributions from banks proportionate to their liabilities and risk profiles. The funds will have to build up sufficient capacity to reach 1% of covered deposits in 10 years. They will be used exclusively for supporting orderly reorganisation and resolution, and never to bail out a bank. National resolution funds would interact, notably to provide funding to resolve cross-border banks.

For an optimal use of resources, the resolution Directive also takes advantage of the funding already available in the 27 Deposit Guarantee Schemes (DGS). The DGS will provide funding, alongside the resolution fund, for the protection of retail depositors. For maximum synergy, Member States will even be allowed to merge the DGS and the resolution fund, as long as all the guarantees are in place to ensure that the scheme remains in position to repay depositors in case of failure.

- *Sub-category 2.3 - Financial Conglomerates*

Appropriate supervision of financial conglomerates – large financial groups active in different financial sectors, often across borders – is important because these firms are often systemically important, either in one Member State of the European Union or for the European Union as a whole.

Focus Area 12: Financial Conglomerates Directive

The ***Financial Conglomerates Directive***[72], which came into force in 2011, gives national financial supervisors new powers to improve how they oversee the conglomerates' parent entities, such as holding companies. The new rules will allow supervisors to apply banking supervision, insurance supervision and supplementary supervision at the same time, as appropriate and necessary, thereby remedying the unintended loopholes identified during the financial crisis. In this way, should a financial conglomerate run into trouble, supervisors should be able to obtain better information at an earlier stage and be better equipped to intervene. In addition, banking groups, insurance groups and conglomerates will be obliged to publish basic elements of a resolution plan for the group or conglomerate. The resolution plan will have to include, their legal structure as compared to their business structure. Finally, managers of alternative investment funds (for example hedge fund managers) will be included in the scope of supplementary supervision when they are part of a conglomerate.

The directive will enhance the prudential soundness and effective supervision of financial conglomerates; promote convergence in national supervisory approaches, and between sectors; improve financial stability and serve as a significant improvement for the protection of depositors, insurance policy holders and investors.

Category 3 - Financial Markets

- *Sub-category 3.1 - Financial Markets Infrastructure*

Focus Area 13: European Market Infrastructure Regulation (EMIR)

Derivatives play an important role in the economy but are associated with certain risks. The crisis has highlighted that these risks are not sufficiently mitigated in the over-the-counter (OTC) part of the market. Since the beginning of the financial crisis, the Commission has been working to address these risks.

On 9 February 2012, the European Parliament and the Council reached an important agreement on a Regulation for more stability, transparency and efficiency in derivatives markets. The Regulation of OTC Derivatives, Central Counterparties and Trade Repositories (known as "***EMIR***" - European Market Infrastructure Regulation) was adopted on 4 July 2012, and entered into force on 16 August 2012.

The Regulation[73] ensures that information on all European derivative transactions will be reported to trade repositories and be accessible to supervisory authorities, including the European Securities and Markets Authority (ESMA), to give policy makers and supervisors a clear overview of what is going on in the markets.

The Regulation also requires standard derivative contracts to be cleared through Central Counterparties (CCPs) as well as margins for uncleared trades and establishes stringent organisational, business conduct and prudential requirements for these CCPs.

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72 Directive 2011/89/EU

73 Regulation (EU) No 648/2012 of the European Parliament and of the Council

On 19 December 2012, the European Commission has adopted nine regulatory and implementing technical standards to complement the obligations defined under the Regulation on OTC derivatives, central counterparties (CCPs) and trade. They were developed by the European Supervisory Authorities and have been endorsed by the European Commission without modification. The technical standards entered into force on 15 March 2013. As with any other EU Regulation, the provisions are directly applicable (i.e. legally binding in all Member States without implementation into national law) from the day of entry into force.

Focus Area 14: Securities Law Directive

In December 2008, the Economic and Financial Affairs (ECOFIN) Council invited the European Commission to present, as a matter of urgency, the outline of legislative measures for a harmonised legal framework for intermediated securities, including the conflict-of-laws issue, and better protection of investors' rights enshrined in their securities.

The Commission Services are currently preparing a draft directive on the legal certainty of securities holding and transactions (***Securities Law Directive*** – SLD). The Directive is expected to address three issues:

- the legal framework of holding and disposition of securities held in securities accounts, covering aspects belonging to the sphere of substantive law as well as conflict-of-laws;
- the legal framework governing the exercise of investor's rights flowing from securities through a "chain" of intermediaries, in particular in cross-border situations;
- the submission of any activity of safekeeping and administration of securities under an appropriate supervisory regime.

We expect the Directive to be adopted by the Commission and transferred to the European legislator in 2013.

Focus Area 15: Central Securities Depositories Directive

Central Securities Depositories (CSDs) are systemically important infrastructures in modern securities markets. They perform crucial services that allow (at a minimum) the registration, safekeeping, and settlement of securities in exchange for cash as well as the efficient processing of securities transactions in financial markets. Given the systemic importance of CSDs and their strategic position at the end of the post-trading process, there is a strong need for an appropriate regulatory framework for CSDs.

On 7 March 2012, the Commission adopted a ***proposal for a Regulation***[74] to improve securities settlements in the European Union and on central securities depositories (CSDs) and to amend Directive 98/26/EC. The Regulation introduces an obligation of dematerialisation for most securities, and harmonises settlement periods for most transactions in such securities, settlement discipline measures and common rules for central securities depositories (CSDs). The Commission's proposal is currently under consideration by the European Parliament and the Council.

On a national level, in 2012 the NBB published a ***circular***[75] for prudential control and oversight of settlement institutions, based on the "Principles for financial market infrastructures" established in April 2012 by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO).

These principles will serve as guidelines for NBB, especially for the evaluation of a) the appropriateness of the management structure, the accounting and administrative organisation and the internal control of settlement institutions, and of b) the organization and operation of financial instruments settlement systems.

[74] Proposal for a regulation COM(2012) 73
[75] NBB_2012_06

- *Sub-category 3.2 - Securities*

Focus Area 16: Market Abuse

In recent years financial markets have become increasingly global, giving rise to new trading platforms and technologies. This unfortunately has also led to new potential for manipulation of these markets. As part of its work to make financial markets more sound and transparent, in October 2011 the European Commission adopted a ***proposal for a regulation on insider dealing and market manipulation***[76] (i.e. market abuse). The proposal aims to update and strengthen the existing framework in order to ensure market integrity and investor protection provided by the Market Abuse Directive[77]. The new framework will ensure regulation keeps pace with market developments, that it strengthens the fight against market abuse across commodity and related derivative markets, that it reinforces the investigative and sanctioning powers of regulators and that it reduces administrative burdens on small and medium-sized issuers.

As a complement to this proposal for a regulation, the European Commission also adopted a ***proposal for a Directive on criminal sanctions for insider dealing and market manipulation***.[78] The objective of this new directive is to ensure minimum criminal sanctions for insider dealing and market manipulation in the 27 EU Member States.

This proposal framework was further updated in July 2012 following the LIBOR scandal where serious concerns were raised about false submissions of banks' estimated interbank lending rates. As any actual or attempted manipulation of such key benchmarks can have a serious impact on market integrity, and could result in significant losses to consumers and investors, or distort the real economy, the European Commission adopted ***two amendments to the proposals for a Regulation***[79] ***and a Directive***[80] on insider dealing and market manipulation, including criminal sanctions. These amendments clearly prohibit the manipulation of benchmarks, including LIBOR and EURIBOR, and make such manipulation a criminal offence.

The proposal framework is under negotiation and is expected to be adopted by the European Parliament and the Council in 2013.

Focus Area 17: Rating Agencies

On 30 May 2012, four Commission ***Delegated Regulations*** establishing regulatory technical standards for credit rating agencies were published in the Official Journal of the European Union. These technical standards include:

(i) the information to be provided by a credit rating agency in its application to register with the European Securities and Markets Authority (ESMA);

(ii) the presentation of the information to be disclosed by credit rating agencies in a central repository (CEREP) so investors can compare the performance of different CRAs in different rating segments;

(iii) how ESMA will assess rating methodologies; and

(iv) the information CRAs have to submit to ESMA and the appropriate time intervals in order to supervise compliance.

The four standards, which complement the existing European regulatory framework[81] for credit rating agencies, were developed by the European Securities and Markets Authority (ESMA) and endorsed by the European Commission on 21 March 2012. The regulatory technical standards should ensure a level playing field, address transparency and adequate protection of investors across the Union and contribute to the creation of a single rulebook for financial services.

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76 COM(2011) 651
77 2003/6/EC
78 COM(2011) 654
79 COM(2012) 421
80 COM(2012) 420
81 COM(2011) 746 & COM(2011) 747

Focus Area 18: Short Selling

At the height of the financial crisis in September 2008, competent authorities in several Member States and supervisory authorities in third countries adopted emergency measures to restrict or ban short selling in some or all securities. They acted based on concerns that in times of considerable financial instability, short selling could aggravate the downward spiral in the prices of shares, notably in financial institutions, in a way that could ultimately threaten their viability and create systemic risks. The measures adopted by Member States were divergent as the Union lacked a specific common regulatory framework for dealing with short selling issues. To ensure the proper functioning of the internal market and to improve the conditions of its functioning, in particular with regard to the financial markets, and to ensure a high level of consumer and investor protection, in September 2010 the European Commission adopted a proposal for ***Regulation on short selling and certain aspects of Credit Default Swaps***[82]. This proposal for a regulation, which was adopted by the European Parliament and the Council in March 2012[83], had as main objectives the establishment of a common regulatory framework in regards to the requirements and powers relating to short selling and credit default swaps and to ensure greater coordination and consistency between Member States where measures have to be taken in exceptional circumstances.

On 5 July 2012 the European Commission further adopted a ***Delegated Act***[84] which sets out important technical rules needed to ensure the uniform application and enforcement of the Short Selling Regulation. The delegated act is part of a package of four implementing measures adopted by the Commission to specify technical aspects of the Short Selling Regulation. A delegated regulation on regulatory technical standards[85] was also endorsed by the Commission on the same date, based on a draft of regulatory technical standards submitted by ESMA. An ***implementing regulation concerning implementing technical standards***[86] and a ***delegated regulation on regulatory technical standards***[87] have already been adopted by the Commission on 29 June 2012.

Focus Area 19: Investor Compensation Scheme

Since 1997, the ***Investor Compensation Scheme Directive***[88] has provided investors who use investment services in Europe compensation should the firm be unable to return money or financial instruments that it holds on the client's behalf.

However, in recent years, the Commission has received numerous investor complaints about the application of the ICSD in a number of important cases involving large investor losses. The complaints are principally related to the coverage and funding of schemes and delays in obtaining compensation.
As part of its mission to create a safer and sounder financial system, prevent a future crisis and restore consumer confidence, in July 2010 the European Commission adopted ***a proposal to amend existing Directive***[89] to further improve protection for bank account holders and retail investors. This initiative is part of a broader package of compensation and guarantee schemes that includes two proposals for the amendment of the Directives on Investor Compensation Schemes and on Deposit Guarantee Schemes[90] and a White Paper on the insurance schemes.

Focus Area 20: Markets in Financial Instruments Directive (MiFID)

In recent years, financial markets have changed enormously. New trading venues and products have come onto the scene and technological developments such as high frequency trading have altered the landscape. Drawing lessons from the 2008 financial crisis, at the 2009 Pittsburgh summit, the G20 agreed on the need to improve the transparency and oversight of less regulated markets – including derivatives markets – and to address the issue of excessive price volatility in commodity derivatives markets.

82 COM(2010) 482
83 (EU) No 236/2012
84 (EU) No 918/2012
85 (EU) No 919/2012
86 (EU) No 827/2012
87 (EU) No 826/2012
88 Directive 97/9/EC
89 COM(2010) 371
90 See Focus Area 10
91 COM(2011) 656

In response to this agreement, the European Commission has tabled ***proposals to revise the Markets in Financial Instruments Directive*** (MiFID) in force since November 2007. These proposals consist of a Directive[91] and a Regulation[92] and aim to make financial markets more efficient, resilient and transparent, and to strengthen investor protections. The new framework will also increase the supervisory powers of regulators and provide clear operating rules for all trading activities.

Key elements of the proposal

- More robust and efficient market structures

  MiFID already covered Multilateral Trading Facilities and regulated markets, but the revision will bring a new type of trading venue into its regulatory framework: the Organised Trading Facility (OTF). These are already existing organised platforms currently unregulated but that play an increasingly important role. The new proposal will close the loophole they provided until now.

- Taking account of technological innovations

  Furthermore, an updated MiFID will introduce new safeguards for algorithmic and high frequency trading activities which have drastically increased the speed of trading and have posed serious possible systemic risks. Finally, the proposals will improve conditions for competition in essential post-trade services such as clearing, which may otherwise frustrate competition between trading venues.

- Increased transparency

  By introducing the OTF category, the proposals will improve the transparency of trading activities in equity markets, including "dark pools" (trading volumes or liquidity that are not available on public platforms). Exemptions would only be allowed under prescribed circumstances. They will also provide a new trade transparency regime for non-equities markets (i.e. bonds, structured finance products and derivatives). In addition, thanks to newly introduced requirements to gather all market data in one place, investors will have an overview of all trading activities in the EU, helping them to make a more informed choice.

- Reinforced supervisory powers and a stricter framework for commodity derivatives markets

  he proposals will reinforce the role and powers of regulators. In coordination with the European Securities and Markets Authority (ESMA) and under defined circumstances, supervisors will be able to ban specific products, services or practices in case of threats to investor protection, financial stability or the orderly functioning of markets. The proposals also foresee stronger supervision of commodity derivatives markets. It introduces a position reporting obligation by category of trader. This will help regulators and market participants to better assess the role of speculation in these markets. In addition, the Commission proposes to empower financial regulators to monitor and intervene at any stage in the trading activity in all commodity derivatives, including in the shape of position limits if there are concerns about disorderly markets.

- Stronger investor protection

  Building on the comprehensive set of rules that already in place, the revised MiFID sets stricter requirements for portfolio management, investment advice and the offer of complex financial products such as structured products. In order to prevent potential conflict of interest, independent advisors and portfolio managers will be prohibited from making or receiving third-party payments or other monetary gains. In addition, rules on corporate governance and managers' responsibility are introduced for all investment firms.

[82] COM(2011) 652

Next steps

The proposals are still under negotiations at the European Parliament and the Council (Member States). Once adopted the Regulation, the Directive, and the necessary technical rules required to implement these changes will be applied together as of the same date.

Focus Area 21: Transparency

The initial Transparency Directive[93], adopted by the European Parliament and the Council in December 2004, requires issuers of securities traded on regulated markets within the European Union ("EU") to ensure appropriate transparency for investors through the disclosure and dissemination of regulated information to the public. The Directive has been implemented under Belgian legislation by the Law of 2 May 2007 and the Royal Decree of 14 February 2008[94].

Five years after the entry into force of this Directive, the Commission published a Report[95] assessing the impact of the Directive. The Report recognised the Directive as useful for the proper and efficient functioning of the market, however it highlighted areas for improvement.

In 2010, the Commission launched a public consultation on the modernisation of the Directive. The main issues raised were: the attractiveness of the regulated markets for small and medium - sized issuers (SMIs) and ways to improve the regime for major holdings of voting rights.

In 2011, the European Commission adopted a proposal[96] for a Directive amending the initial Transparency Directive. The measures proposed should simplify certain obligations so as to help ensure that regulated markets are attractive to SMIs, and improve the legal clarity and effectiveness of the transparency regime with respect to the disclosure of corporate ownership.

- *Sub-category 3.3 - Investment funds*

In the EU, investment funds can be broadly categorised as UCITS (Undertakings for Collective Investment in Transferable Securities) and non-UCITS (or non-harmonised) funds. The former are those that comply with the harmonised rules laid down in the ***UCITS Directive***[97] and are authorised for sale to the retail market. For the purposes of the proposed Directive, Alternative Investment Funds (AIF) are defined as all funds that are not harmonised under the UCITS Directive.

Focus Area 22a: UCITS

As mentioned, UCITS are investment funds that have been established in accordance with UCITS Directive, adopted in 1985 and then replaced later by ***Directive 2009/65/EC*** (referred to as "UCITS IV"), which has been implemented under Belgian legislation through the Belgian Law of 3 August 2012 and the Royal Decree of 12 November 2012.

On 1 July 2010 the Commission further improved the EU framework for investment funds by adopting ***four implementing acts*** (two directives[98] and two regulations[99]) under Directive 2009/65/EC. These implementing measures were split across four separate instruments (key investor information, rules for the conduct of UCITS management companies, UCITS mergers and master-feeder structures, notification procedure and supervisory co-operation), which, together with the recast of the UCITS Directive and supporting CESR guidelines, formed a package that laid the basis for an efficient and competitive UCITS market for the future. They have been prepared on the basis of advice from CESR[100] and were approved by Member States and subsequently the European Parliament and the Council.

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93 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004
94 FSMA-2011-08
95 COM (2010) 243 FINAL of 27 May 2010
96 COM(2011) 683
97 Council Directive 85/611/EEC
98 Directives 2010/42/EU & 2010/43/EU
99 Regulations (EU) No 583/2010 & (EU) No 584/2010
100 The Committee of European Securities Regulators

Finally, on 3 July 2012 the Commission adopted ***a proposal for a directive***[101] (referred to as "UCITS V") amending Directive 2009/65/EC in the matter of depositary functions, remuneration policies and sanctions and on 26 July 2012, the EU Commission services launched a ***consultation*** (referred as "UCITS VI") that focused on UCITS product rules, extraordinary liquidity management tools, depositary passport, money market funds, and long-term investments.

Focus Area 22b: AIFMD
In response to the financial crisis, in 2009 the European Commission adopted a ***proposal for a Directive on Alternative Investment Fund Managers***[102] (AIFMs) with the objective to create a comprehensive and effective regulatory and supervisory framework for AIFMs at the European level. The final text of the ***Directive***[103] was adopted in June 2011 after political agreements were reached by the European Parliament and the Council of Ministers in November 2010.

On 19 December 2012 the European Commission adopted a ***Delegated Regulation***[104] supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.

Cross-sector Issues

- ### *Sub-category 4.1 - Financial Crime*

Focus Area 23: Money laundering and terrorist financing
On 5 February 2013 the Commission adopted two proposals to reinforce the EU's existing rules on anti-money laundering and fund transfers. The threats associated with money laundering and terrorist financing are constantly evolving, which requires regular updates of the associated rules.

The package, which complements other actions taken or planned by the Commission in respect to the fight against crime, corruption and tax evasion, includes:

- o A ***directive***[105] on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing
- o A ***regulation***[106] on information accompanying transfers of funds to secure "due traceability" of these transfers

Both proposals provide a more targeted and focussed risk-based approach.

In particular, the new Directive improves clarity and consistency of the rules across the Member States, extends its scope to address new threats and vulnerabilities, promotes high standards for anti-money laundering and strengthens the cooperation between the different national Financial Intelligence Units (FIUs). The tasks of these units are to receive, analyse and disseminate to competent authorities any suspicions of money laundering or terrorist financing.

The two proposals are part of a reinforcement of the sanctioning powers of the competent authorities. For example, they introduce a set of minimum principle-based rules to strengthen administrative sanctions and a requirement for them to coordinate actions when dealing with cross-border cases.

On a national level the Belgian Law of 11 January 1993, designed to prevent the use of the financial system for money laundering purposes and financing of terrorism, was amended in 2012 by the ***Program Law of 29 March 2012*** to harmonise Belgian legislation with the practices of the neighbouring countries. On 1st March 2011, the CBFA also published a Circular[107] modifying Circular of 6 April 2010 on the customer due diligence obligation, the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, and the prevention of the financing of the proliferation of weapons of mass destruction.

101 COM(2012) 350
102 COM(2009) 207
103 Directive 2011/61/EU
104 C(2012) 8370
105 COM(2013) 045
106 COM(2013) 044
107 CBFA_2011_09

- *Sub-category 4.2 - General policies*

Focus Area 24: Shadow Banking
A lot of effort in the last few years has been focused on implementing the reforms linked to the G20 commitments. However, there is an increasing field of non-bank credit activity, or ***shadow banking***, which until now has not been part of the primary focus of prudential regulation and supervision.

Shadow banking plays an important role in the financial system. For example, it creates additional sources of funding and offers investors alternatives to bank deposits. But it can also pose potential threats to long-term financial stability.

At the November 2010 Seoul Summit, the G20 leaders requested that the FSB, in collaboration with other international standard-setting bodies, develop recommendations to strengthen the oversight and regulation of the "shadow banking system". In response, the FSB released a report on 27 October 2011[108] on strengthening oversight and regulation of shadow banking.

Building on this report and on the invitation of the November 2011 G20 Cannes Summit to develop its work further, the FSB has also initiated five work-streams tasked with analysing the issues in more detail and developing effective policy recommendations. At the Los Cabos Summit in June 2012, the G20 leaders reiterated their support for the shadow banking work and asked the FSB to submit its recommendations for review at the G20 Finance Ministers and Central Bank Governors meeting in November 2012. The Consultative Document on Strengthening Oversight and Regulation of Shadow Banking[109] issued by the FSB in November 2012 comprises a) an integrated overview of policy recommendations, b) a policy framework for oversight and regulation of shadow banking entities, and c) a policy framework for addressing shadow banking risks in securities lending and repos. The FSB expects to publish final recommendations in September 2013.

Against this background, the European Commission also issued a Green Paper on Shadow Banking[110] in March 2012. The purpose of this Green Paper was to take stock of current developments, and to present on-going reflections on the subject to allow for a wide-ranging consultation of stakeholders.

Focus Area 25: Banking Union
At the European Council and the Euro area summit of 28/29 June 2012, EU leaders agreed to deepen the economic and monetary union as one of the remedies for the current crisis. One of the main building blocks towards deeper integration is a banking union.
On 12 September 2012 the Commission proposed a ***single supervisory mechanism (SSM)*** for banks led by the European Central Bank (ECB) in order to strengthen the Economic and Monetary Union. The set of proposals is a first step towards an integrated "banking union" which includes further components such as a single rulebook, common deposit protection and a single bank resolution mechanism. The proposals include:

- a regulation[111] that gives the ECB and national supervisory authorities extensive decision making power in the supervision of all banks in the Euro area (i.e. the creation of a single supervisory mechanism);
- a regulation[112] with limited and specific changes to the regulation setting up the European Banking Authority (EBA) to ensure a balance in its decision making structures between the Euro area and non-Euro area Member States;
- a communication[113] outlining the Commission's overall vision for rolling out the banking union, covering the single rulebook, common deposit protection and a single bank resolution mechanism.

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108 http://www.financialstabilityboard.org/publications/r_111027a.pdf
109 http://www.financialstabilityboard.org/publications/r_121118.pdf
110 COM(2012) 102
111 COM(2012) 511
112 COM(2012) 512
113 COM(2012) 510

Specific supervisory tasks will be shifted to the European level in the Euro area, notably those that are key to preserving financial stability and detecting viability risks of banks. The ECB will become responsible for tasks such as authorizing credit institutions; compliance with capital, leverage and liquidity requirements; and conducting supervision of financial conglomerates. The ECB will have the power to carry out early intervention measures when a bank breaches or risks breaching regulatory capital requirements by requiring banks to take remedial action.

The ECB will cooperate with the EBA within the framework of the European System of financial supervision. The role of the EBA will be similar to its current role: it will continue developing the single rulebook applicable to all 27 Member States and ensure that supervisory practices are consistent across the whole Union.

For cross-border banks active both within and outside Member States participating in the SSM, existing home/host supervisor coordination procedures will continue to exist as they do today. To the extent that the ECB has taken over supervisory tasks, it will carry out the functions of the home and host authority for all participating Member States.

To allow for a smooth transition to the new mechanism, a phasing-in period is planned. As a first step, as of 1 January 2013, the ECB will be able to assume full supervisory responsibility over any credit institution, particularly those which have received or requested public funding. As of 1 July 2013 all banks of major systemic importance will be put under the supervision of the ECB. The phasing-in period should be completed by 1 January 2014 at which point the SSM will cover all banks.

As a next step the Commission envisages making a proposal for a ***single European resolution mechanism*** to deal efficiently with cross-border bank resolution and avoid taxpayers' money going to rescuing banks.

Focus Area 26: Structural Reform

High-level Expert Group on reforming the structure of the EU banking sector

In November 2011, Commissioner Michel Barnier announced his intention to set up a High-level Expert Group to examine possible reforms to the structure of the EU's banking sector. The Group's members were announced in February 2012 and the Group presented its final report[114] to the Commission on 2 October 2012.

Its mandate was to determine whether, in addition to ongoing regulatory reforms, structural reforms of EU banks would strengthen financial stability and improve efficiency and consumer protection, and if that be the case, to make proposals as appropriate.

The Group recommends a set of five measures:

- o First, proprietary trading and other significant trading activities should be assigned to a ***separate legal entity*** if the activities to be separated amount to a significant share of a bank's business. This would ensure that trading activities beyond the threshold are carried out on a stand-alone basis and separate from the deposit bank. As a consequence, deposits, and the explicit and implicit guarantee they carry, would no longer directly support risky trading activities. The long-standing universal banking model in Europe would remain untouched, however, since the separate activities would be carried out in the same banking group. Hence, banks' ability to provide a wide range of financial services to their customers would be maintained.
- o Second, the Group emphasises the need for banks to draw up and maintain ***effective and realistic recovery and resolution plans***, as proposed in the Commission's Bank Recovery and Resolution Directive (BRR). The resolution authority should request wider separation than considered mandatory above if this is deemed necessary to ensure resolvability and operational continuity of critical functions.

[114] High-level Expert Group on reforming the structure of the EU banking sector, http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf

- o Third, the Group strongly supports the ***use of designated bail-in instruments***. Banks should build up a sufficiently large layer of "bail-inable" debt that should be clearly defined, so that its position within the hierarchy of debt commitments in a bank's balance sheet is clear and investors understand the potential actions in case of resolution. Such debt should be held outside the banking system. The debt (or an equivalent amount of equity) would increase overall loss absorptive capacity, decrease risk-taking incentives, and improve transparency and pricing of risk.
- o Fourth, the Group proposes to apply ***more robust risk weights*** in the determination of minimum capital standards and ***more consistent treatment of risk in internal models***. Following the conclusion of the Basel Committee's review of the trading book, the Commission should review whether the results would be sufficient to cover the risks of all types of European banks. Also, the treatment of real estate lending within the capital requirements framework should be reconsidered, and maximum loan-to-value (and/or loan-to-income) ratios included in the instruments available for micro- and macro-prudential supervision.
- o Finally, the Group considers that it is necessary to ***increase existing corporate governance reforms*** by specific measures to a) strengthen boards and management; b) promote the risk management function; c) rein in compensation for bank management and staff; d) improve risk disclosure and e) strengthen sanctioning powers.

Structural banking reforms in Belgium

In parallel to the study carried out at the European level, a similar reflexion on the desirability and feasibility of introducing structural reforms, such as distinguishing between commercial and investment banks or establishing a ring fence for retail banks, has been performed by NBB upon request of the Belgian government.

In response to this request, the NBB issued a report[115] in June 2012, which examines the issue of structural reforms and presents the NBB's provisional views regarding appropriate measures to improve stability of the Belgian financial system.

In terms of more specific objectives for structural reforms, NBB assessed potential measures according to the following criteria: a) limiting the possibility for deposit-taking banks in Belgium to become insolvent as a result of activities (possibly undertaken by other entities within the group) that are either highly risky or are undertaken entirely in other countries; and b) improving the resolvability of deposit-taking banks in Belgium.

The measures proposed by NBB represent a combination of key elements from both the US Volcker Rule and the UK Vickers Reforms, while being adapted to the characteristics of the Belgian financial system:

- o Recovery and Resolution Plans (RRPs)

  Measure 1: Require the formulation of recovery and resolution plans for all domestic systemically important banks.

  Measure 2: Improve the effectiveness of the 2010 resolution law through: a) making the role of the NBB as a resolution authority more precise, for systemic and nonsystemic banks: (2) specifying shorter time periods for the court to render a decision on requests by authorities when applying the resolution powers to a failing bank; and (3) allowing for non-public hearings between the court and regulatory authorities.
- o Capital surcharges (and other policies) for SIFIs

  Measure 3: In the context of applying intensified supervision to Belgian D-SIBs, formulate a definition of strategic decisions for Belgian D-SIBs that includes any changes in the bank's operations or activities that could potentially have an impact on resolvability.

115 Interim report: Structural banking reforms in Belgium, http://www.nbb.be/doc/ts/publications/NBBReport/2012/StructureleHervormingen_En.pdf

- o Rules relating to intra-group exposures

  Measure 4: Extend the intra-group exposure limits to include exposures of the Belgian banks to their subsidiaries.

- o Ring-fencing or prohibition of activities

  Measure 5: Apply targeted Pillar 2 capital surcharges to banks' trading activities, above some threshold, in order to raise the cost of these activities and ensure that trading activities will not constitute a significant obstacle to banks' resolvability.

  Measure 6: Make the subsidization of savings more neutral with respect to the type of instrument, thereby diversifying the channels through which savings are allocated to investment in the real economy.

Focus Area 27: Supervision (BE)

Recovery and Resolution[116]

An essential condition for resolution plans, which are developed by authorities, to succeed in improving the resolvability of banks is for national authorities to possess the necessary tools and powers to resolve large, complex banks in an orderly way. In ***June 2010*** Belgium passed ***two laws*** that confer such powers on authorities[117]. These laws allow authorities, subject to a royal decree, to transfer or sell the activities, assets or liabilities of institutions which are likely to fail and which would have an impact on the financial system in the absence of the authorities' intervention. The 2010 laws also allow for the creation of vehicles such as bridge banks or "bad" banks, which help to facilitate the orderly resolution of complex banks.

Prudential Supervision

The ***Royal Decree of 3 March 2011*** implementing the ***Law of 2 July 2010***[118] (amending the ***Law of 2 August 2002*** on the supervision of the financial sector and on financial services) assigns to the National Bank of Belgium a prudential supervisory role over the main financial institutions, with effect from 1 April 2011. The Law of 2 July 2010 introduces a bipolar system of oversight ("Twin Peaks") which gives the National Bank general control over prudential supervision and gives the new Financial Services and Markets Authority (FSMA), that is taking over from the CBFA, responsibility for supervising the financial markets and ensuring consumer protection. Henceforth, the National Bank of Belgium is responsible notably for supervising the banks, insurance companies and stockbroking firms. This monitoring of individual financial institutions comes on top of the job of ensuring the smooth operation of the financial system as a whole. Besides monetary stability, maintaining an efficient and reliable financial system is one of the priorities of any central bank.

External mandates

The ***Royal Decree of 20 June 2012*** ratifies the regulation of the National Bank of Belgium of 6 December 2011 concerning the external mandates of directors of regulated companies.

Focus Area 28: Supervision (US) - Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act[119] (Dodd-Frank Act), signed into law July 2010, covers many topics and has vast requirements. This complex law is mandated to address a lack of transparency, market vulnerability and egregious practices by any publicly traded corporation.

Most corporations are reviewing their strategies for sustainability, capital and growth in light of Dodd-Frank. The law impacts approximately 6,000 publicly traded companies, both in financial services and non-financial services. Dodd-Frank focuses on assuring stability in the U.S. financial markets, mainly by regulating institutions deemed systemically important, such as the OTC derivatives market and investment advisors, and enhancing consumer protections.

116 Interim report: Structural banking reforms in Belgium, National Bank of Belgium, June 2012

117 "Loi du 2 juin 2010 visant à compléter les mesures de redressement applicables aux entreprises relevant du secteur bancaire et financier" and "Loi du 2 juin 2010 complétant, en ce qui concerne les voies de recours, la loi du 2 juin 2010 visant à compléter les mesures de redressement applicables aux entreprises relevant du secteur bancaire et financier."

118 CBFA_2011_15

119 Dodd-Frank Act , http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

This sweeping legislation and accompanying rules contain numerous provisions intended to strengthen corporate accountability, affecting all U.S. public and many private companies. The Act will also have an impact on non-US companies who have banking or other financial operations in the US .

Focus Area 29: Financial Transaction Tax (FTT)

The financial sector was a major cause of the crisis and received substantial government support over the past few years. To ensure that the sector makes a fair and substantial contribution to public finances and for the benefit of citizens, enterprises and Member States, in September 2011 the European Commission tabled a proposal[121] for a common system of financial transactions tax (FTT).

Following intense discussions on this file, there was consensus at the ECOFIN meetings in summer 2012 that unanimity between the 27 Member States would not be reached within a reasonable period. Nonetheless, a number of Member States expressed a strong willingness to go ahead with the FTT. Therefore, in autumn 2012, 11 Member States wrote to the Commission, officially requesting enhanced cooperation on the financial transaction tax to be authorised, on the basis of the Commission's 2011 proposal.

The Commission carefully assessed these requests against the criteria for enhanced cooperation in the Treaties. In particular, it was established that enhanced cooperation on the FTT would not have a negative impact on the Single Market or on obligations, rights and competences of non-participating Member States. On the basis of that assessment, in October 2012, the Commission proposed a Decision to allow enhanced cooperation on the FTT. This was backed by the European Parliament in December and agreed by European Finance Ministers at the ECOFIN in January 2013.

Once the green light for enhanced cooperation had been given, the Commission could proceed with the detailed proposal on the FTT to be applied by the 11 Member States. On 14 February 2013 the European Commission adopted a proposal for a Council Directive[122] implementing enhanced cooperation in the area of financial transaction tax, which mirrors the scope and objectives of the original FTT proposal of September 2011. The approach of taxing all transactions with an established link to the FTT-zone is maintained, as are the rates of 0.1% for shares and bonds and 0.01% for derivatives.

Through the FTT, the financial sector will properly participate in the cost of re-building the economies and bolstering the public finances of the participating Member States. The proposed Directive will reduce the number of divergent national tax regimes in the EU, will generate significant revenues and help to ensure greater stability of financial markets, without posing undue risk to EU competitiveness.

Objectives of the FTT

There are three core objectives to the FTT. First, it will strengthen the Single Market by reducing the number of divergent national approaches to financial transaction taxation. Secondly, it will ensure that the financial sector makes a fair and substantial contribution to public revenues. Finally, the FTT will support regulatory measures in encouraging the financial sector to engage in more responsible activities, geared towards the real economy.

Key elements of the proposal

As in the original proposal, the FTT will have low rates, a wide base and safety nets against the relocation of the financial sector. As before, the "residence principle" will apply. This means that the tax will be due if any party in the transaction is established in a participating Member State, regardless of where the transaction takes place. This is the case both if a financial institution engaged in the transaction is, itself, established in the FTT-zone, or if it is acting on behalf of a party established in that jurisdiction.

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[120] KPMG publication, Dodd-Frank for Foreign Financial Institutions - Geared up for change?, May 2012, http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/dodd-frank-for-foreign-financial-institutions.pdf

[121] COM(2011) 594

[122] COM/2013/71

As a further safeguard against avoidance of the tax, the proposal also adds the "issuance principle". This means that financial instruments issued in the 11 Member States will be taxed when traded, even if those trading them are not established within the FTT-zone. Furthermore, explicit anti-abuse provisions are included.

As in the original proposal, the FTT will not apply to day-to-day financial activities of citizens and businesses (e.g. loans, payments, insurance, deposits etc.), in order to protect the real economy. Nor will it apply to the traditional investment banking activities in the context of the raising of capital or to financial transactions carried out as part restructuring operations.

The proposal also ring-fences refinancing activities, monetary policy and public debt management. Therefore, transactions with central banks and the ECB, with the European Financial Stability Facility and the European Stability Mechanism, and transactions with the European Union will be exempted from the tax.

Next Steps

The proposed Directive will now be discussed by Member States, with a view to its implementation under enhanced cooperation. All 27 Member States may participate in the discussions on this proposal. However, only the Member States participating in enhanced cooperation will have a vote, and they must agree unanimously before it can be implemented. The European Parliament will also be consulted.

Focus Area 30: Foreign Account Tax Compliance Act (FATCA)[123]

The Foreign Account Tax Compliance Act[124] (FATCA) is legislation that was enacted in 2010 by the US Congress to fund the employment boosting measures included in President Obama's HIRE Act. The purpose of FATCA is straightforward. It aims to ensure certain US investors with financial accounts outside of the US, pay taxes on their income. To achieve this, FATCA will require all global financial institutions – not only banks – to report the names and account details of all US persons on an annual basis. To kick start the process, all foreign financial institutions will be able to enter into an agreement with the US Internal Revenue Service (IRS) committing them to meet a series of reporting and withholding obligations. The Act will be phased in from January 2014.

The FATCA rules are important as they contain two strong levers to ensure compliance:

- Individual account compliance: Foreign financial institutions may be required to withhold 30 percent on US source FDAP[125] income and the sale or other disposition of a US equity or debt obligation issued by a US person that is not adequately documented, and remit it to the IRS.
- Financial institution compliance: When a financial institution is passing a payment onto a second financial institution that has not yet entered into an agreement with the IRS, the first financial institution will be required to withhold 30% on all US sourced payments unless the financial institution discloses all US account holders.

FATCA is not just a tax issue. The FATCA legislation will impact financial institutions along several points in their client value chain. They will need additional client data, new reporting mechanisms and systems to deliver them. Implementing the necessary changes that are required by the effective date will be intensive and difficult to achieve as it crosses many different internal groups and requires different technical expertise.

FATCA requires global coordination. To prepare for FATCA, financial institutions will need to coordinate FATCA implementation across different jurisdictions, reconciling several national legal frameworks.

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123 KPMG, FATCA-Background, http://www.kpmg.com/global/en/industry/financial-services/pages/facta-background.aspx
124 http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA)
125 FDAP - Fixed, Determinable, Annual, Periodical

Category 4 - Other

- ### *Sub-category 4.1 - Accounting*

Focus Area 31: IFRS - Proposed amendments to IFRS 9[126]

Since November 2008, the IASB is revising its accounting requirements for financial instruments. The objectives of the project include improving the decision-usefulness of financial statements for users by simplifying the classification and measurement requirements for financial instruments. This project aims to replace the existing standard IAS39 Financial Instruments: Recognition and Measurement.

The IAS 39 replacement project is driven in part by requests for reform from the Group of Twenty (G20) and other constituents. Following the G20 summit in April 2009, the Leaders' Statement called on accounting standard setters to work urgently with supervisors and regulators to improve standards and achieve a single set of high-quality global accounting standards.

The IASB structured its project in three phases:

- Phase 1: Classification and measurement of financial instruments

  The IASB issued IFRS 9 Financial Instruments (2009)[127] and IFRS 9 (2010)[128], which contain the requirements for the classification and measurement of financial assets and financial liabilities. Those standards have an effective date of 1 January 2015. In November 2012, the IASB issued an exposure draft[129] on limited amendments to the classification and measurement requirements of IFRS 9. The proposed changes would introduce a 'fair value through other comprehensive income' (FVOCI) measurement category for particular financial assets.

- Phase 2: Impairment of financial assets

  The IASB was working together with FASB on a model for the impairment of financial assets based on expected credit losses, which would replace the current incurred loss model in IAS39. The Boards previously published their own differing proposals in November 2009[130] (the IASB) and in May 2010[131] (the FASB), and published a joint supplementary document[132] on recognising impairment in open portfolios in January 2011. However, at the July 2012 joint meeting the FASB expressed concern about the direction of the joint project and in December 2012 issued an exposure draft[133] of its own impairment model, which remains the current expected credit loss model. Meanwhile, the IASB has continued to develop separately its three-bucket impairment model and issued an exposure draft[134] on 07 March 2013.

- Phase 3: Hedge accounting

  The IASB has split the hedge accounting phase into two parts: general hedging and macro hedging. It issued a review draft[135] of a general hedging standard in September 2012, and is working towards issuing a discussion paper on macro hedging in the second half of 2013.

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126 KPMG publication, IFRS Newsletter – Financial Instruments, February 2013, http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Publicationseries/Financial-Instruments-Newsletter/Documents/Financial-Instruments-Newsletter-O-201302-10.pdf

127 Exposure Draft ED/2009/7, Financial Instruments: Classification and Measurement

128 Exposure Draft ED/2010/4, Fair Value Option for Financial Liabilities

129 Exposure Draft ED/2012/4, Classification and Measurement: Limited Amendments to IFRS 9

130 Exposure Draft ED/2009/12, Financial Instruments: Amortised Cost and Impairment

131 Exposure Draft 1810-100, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

132 Supplement to ED/2009/12, Financial Instruments: Impairment

133 Exposure Draft 2012-260, Financial Instruments—Credit Losses

134 Exposure Draft ED/2013/3, Financial Instruments: Expected Credit Losses

135 Available on the IASB website: http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-Instruments-A-Replacement-of-IAS-39-Financial-Instruments-Recognitio/Phase-III-Hedge-accounting/Pages/Draft-of-IFRS-General-Hedge-Accounting.aspx


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Appendix B – List of regulations

Category	Sub-cat	Name	No	Legislation/regulation	Description	Authority	Status	Effective	Effect on balance-sheet	Effect on business model	Effect on operating model	Effect on change capacity
1. Consumer issues	1.1. Payment services	PSD	1	Payment Services Directive (PSD) - 2007/64/EC	European directive to support SEPA	EU	Effective	2009				
		EMD	2	Electronic Money Directive (EMD) - 2009/110/EC	Electronic money directive	EU	Effective	2011				
				Belgian Law of 27/11/2012	Implementation of EMD under Belgian law	BE	Effective	2012				
	1.2. Retail Financial Services	Consumer Credit	3	Consumer Credit Directive 2008/48/EC	European directive to offer consumers better protection against lenders and for a more transparent European market	EU	Effective	2010				
				Act of 13 June 2010 (the "Act") amending the Consumer Credit Act of 12 June 1991.	Implementation in Belgian law of Consumer Credit Directive (2008/48/EC)	BE	Effective	2010				
				Consumer Finance Protection	Consumer protection directive FSB, 26 October 2011	INT	Implementation	-				
				Directive 2011/83/EU on consumer rights	EU directive on consumer rights	EU	Implementation	2013*				
		Mortgage credit	4	Law of 4 August 1992 (Unofficial coordinated version: 06/2005)	Law related to mortgage loans	BE	Effective	1992				
				Mortgage Credit Directive - COM(2011)142	European mortgage directive	EU	Negotiations	2013*				
		PRIPs	5	Packaged Retail Investment Products (PRIPs) - COM(2012) 352	Directive on information for consumers	EU	Negotiations	2014				
2. Financial Institutions	2.1. Corporate governance and remuneration policies	Remuneration	6	Circular NBB-2011-05	Belgian circular on remuneration policy, implementing CEBS Guidelines on Remuneration Policies and Practices	BE	Effective	2011				
				Circular NBB-2012-09	EBA guidelines (27/07/2012) on the Remuneration Benchmarking Exercice (EBA/GL/2012/4)	BE	Effective	2012				
				Circular NBB-2012-10	EBA guidelines (27/07/2012) on the Data Collection Exercise Regarding High Earners (EBA/GL/2012/5)	BE	Effective	2012				
				ESMA/2012/570	ESMA consultation paper - Guidelines on remuneration policies and practices (MiFID), Sept. 2012	EU	-	-				
		Governance	7	Circular PPB-2007-6-CPB-CPA	Prudential expectations regarding financial institutions corporate governance	BE	Effective	2007				
				Joint circular on compliance function Circular NBB-2012-14 Circular FSMA-2012-21	ESMA guidelines on certain aspects of the MiFID suitability requirements and ESMA guidelines on certain aspects of the MiFID compliance function requirements (ESMA/2012/387 & ESMA/2012/388)	BE	Effective	2012				
		Corporate governance and remuneration policies	8	Corporate Governance in Financial Institutions and Remuneration Policies Green Paper COM(2010)284	European proposals for governance and remuneration for financial institutions	EU	-	-				
	2.2. Banking	Regulatory Capital CRDIV/BaselIII	9	Capital Requirements Directive / Regulation (CRD IV Package) COM(2011)453 & COM(2011)452	European Directive and Regulation for capital and liquidity requirements	EU	Implementation	2014*				
				Circular NBB_2012_03	CEBS guidelines (12/10/2010) on the management of operational risks in market-related activities	BE	Effective	2012				
				Circular NBB-2012-08	EBA guidelines (16/05/2012) on Stressed Value-At-Risk and on the Incremental Default and Migration Risk Charge (IRC)	BE	Effective	2012				
		Deposit guarantee schemes and bank contributions	10	Royal Decree of 22 April 2012 concerning financial stability	Establishment of State guarantee relative to the granted credits and other operations made within the framework of the financial stability	BE	Effective	2012				
				Law of 28 December 2011 and RD of 23 February 2012 modifying RD of 14/11/2008	Contribution to the Resolution Fund Contribution to the Protection Fund	BE	Effective	2012				
				Legislative proposal for revision of the Deposit Guarantee Scheme (DGS) - COM(2010)369	European deposit guarantee scheme directive	EU	Implementation	2013*				
				Royal decree 3 August 2012 (page 35)	Annual tax on credit institutions	BE	Effective	2012				
		Crisis Management & Bank resolution	11	Crisis Management Framework COM(2012)280	On 6 June 2012, the Commission adopted a legislative proposal for bank recovery and resolution (incl.bail-in debt)	EU	Negotiations	2015*				
	2.3. Financial conglomerates	FCD	12	Financial Conglomerates Directive (FCD) - 2011/89/EU	European directive for conglomerates with banking and insurance licences	EU	Effective	2011				
3. Financial Markets	3.1. FM Infrastructure	EMIR	13	European Market Infrastructure Regulation (EMIR)	European regulation No 648/2012 of the European Parliament and of the council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories	EU	Implementation	2013				
		SLD	14	Securities Law Directive (SLD)	European custodian legislation. The Commission Services are currently preparing a draft Directive on legal certainty of securities holding and transactions (Securities Law Directive – SLD).	EU	Preparation	2014*				
		CSD	15	Central Securities Depositories Directive (CSDD)	European directive for harmonising resolution of depositories	EU	Negotiations	2015*				
				NBB_2012_06	Guidelines for prudential control and oversight for securities settlement	BE	Effective	2012				
	3.2. Securities	Market Abuse	16	Proposal for Market Abuse Directive & Regulation (MAD) II COM(2011) 651 & COM(2011) 654 + amendemends COM(2012) 420 & COM(2012) 421	European directive and regulation for implementation of criminal law policy in financial system	EU	Negotiations	2013*				
		Rating Agencies	17	Credit Rating Agencies (CRA II & III) COM(2011)746 & COM(2011)747	European regulations for credit rating agencies	EU	Negotiations	2013				
		Short selling	18	Short Selling Regulation - 236 / 2012	European regulation for short selling and credit default swaps	EU	Implementation	2012				
		ICS	19	Investor Compensation Scheme (ICS) - COM(2010)371 (Directive 97/9/EC)	European directive for investor compensation scheme	EU	Negotiations	2013*				
		MIFID	20	Markets in Financial Instruments Directive & Regulation (MiFID I)	European directive and regulation (restructuring) of markets for financial instruments.	EU	Effective	2007				
				Royal Decree of 3 June 2007	Implementation of MIDIF I in Belgian law	BE	Effective	2007				
				Markets in Financial Instruments Directive & Regulation (MiFID) II - COM(2011)652 & COM(2011)656	European directive and regulation (restructuring) of markets for financial instruments.	EU	Negotiations	2014*				
		Transparency	21	Proposal of a Directive modifying the Transparency Directive 2004/109/EC - COM(2011)683	European transparency requirements regarding information about institutions issuing securities for trade	EU	Negotiations	2013*				
				Royal Decree of 14/02/2008 Law of 2/05/2007	Implementation of Transparency Directive in Belgian law	BE	Effective	2007				

Category	Sub-cat	Name	No	Legislation/regulation	Description	Authority	Status	Effective	Effect on balance-sheet	Effect on business model	Effect on operating model	Effect on change capacity
	3.3 Investment Funds	UCITS / AIFMD	22	Alternative Investment Fund Manager Directive (2011/61/EU 8 June 2011) + Delegated Regulation C(2012) 8370 supplementing Directive 2011/61/EU Undertakings for Collective Investment in Transferable Securities UCITS IV 2009/65/CE & UCITS V COM(2012) 350 (3 July 2012 - proposal for a directive amending Directive 2009/65/EC) Law of 3 August 2012 Royal Decree of 12 November 2012	Directive for alternative investment fund managers European directive for coordinating the legal and administrative law requirements for UCITS Implementation of UCITS IV directive in Belgian law	EU EU BE	Negotiations Negotiations Effective	2013 * 2013* 2012				
4. Cross-sector issues	4.1. Financial Crime	Money laundering and terrorist financing	23	Law of 11 January 1993 (Unofficial coordinated version: 06/2012) European Directive and Regulation COM(2013) 045 & COM(2013) 044 CBFA_2011_09	Law on preventing use of the financial system for purposes of laundering money and terrorism financing EU legal framework to protect the financial system against money laundering and terrorist financing. Circular CBFA_2011_09 modifying circular CBFA_2010_09 of 6 April 2010 on the customer due diligence obligation, the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, and the prevention of the financing of the proliferation of weapons of mass destruction (01-03-2011)	BE EU BE	Effective Implementation Effective	2012 2013* 2011				
	4.2. General Policy	Shadow Banking	24	FSB's policy recommendations on shadow banking, November 2012	FSB Publishes Initial Integrated Set of Recommendations to Strengthen Oversight and Regulation of Shadow Banking	INT	Preparation	N/A				
		Banking Union	25	Proposals for a single supervisory mechanism, COM(2012) 510 & 511 & 512	On 12 September 2012, the Commission proposed a single supervisory mechanism (SSM) for banks led by the European Central Bank (ECB) in order to strengthen the Economic and Monetary Union. The set of proposals is a first step towards an integrated "banking union" which includes further components such as a single rulebook, common deposit protection and a single bank resolution mechanisms.	EU	Preparation	2014*				
		Structural reform (ring-fencing)	26	High-level Expert Group on reforming the structure of the EU banking sector, Final Report, October 2012 (Liikanen report) Interim report: Structural Banking Reforms in Belgium	The first measure proposed in the Liikanen report refers to legal separation of certain risky financial activities from deposit-taking banks within a banking group The NBB has been asked by the Belgian government to analyze the desirability and feasibility of introducing structural reforms in Belgium, such as distinguishing between commercial and investment banks or establishing a ring fence for retail banks.	EU BE	Preparation Preparation	N/A 2013 *				
		Supervision (BE)	27	Law of 22 March 1993 Law of 2 August 2002 Law of 2 June 2010 Royal Decree of 20 June 2012	Law on the status and supervision of credit institutions Law on supervision of the financial sector and financial services Law to extend the recovery measures for companies in the banking and financial sector Royal Decree concerning the external mandates of directors of regulated companies	BE BE BE BE	Effective Effective Effective Effective	1993 (2012) 2002 (2011) 2010 2012				
		Supervision (US)	28	Dodd-Frank Act (DFA)	US legislation to reform financial system	US	Implementation	2010				
		FTT	29	Financial Transaction Tax (FTT) - COM/2013/71	On 14 February 2013 the European Commission adopted a proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, which mirrors the scope and objectives of its original FTT proposal of September 2011. This follows the decision of the Council on 22 January 2013 to authorise enhanced cooperation between 11 Member States and the consent of the European Parliament given on 12 December 2012.	EU	Negotiations	2014				
		FATCA	30	Foreign Account Tax Compliance Act (FATCA)	US tax compliance legislation	US	Implementation	2014				
5. Other	5.1. Accounting	IFRS	31	International Financial Reporting Standards / International Accounting Standards IFRS 9, IFRS 10, IFRS 13, IAS 19R, IAS 32	International standards of the IASC for financial instruments, consolidation and fair value, pension obligations	INT	Negotiations	2015*				

Scoring system

Not applicable
Limited impact
Average impact
Large impact

Source: KPMG analysis

Note: * KPMG expectation


market
market


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Appendix C - References

External Sources

- http://www.esma.europa.eu/
- http://www.fsma.be
- http://www.nbb.be
- http://ec.europa.eu

KPMG Publications

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