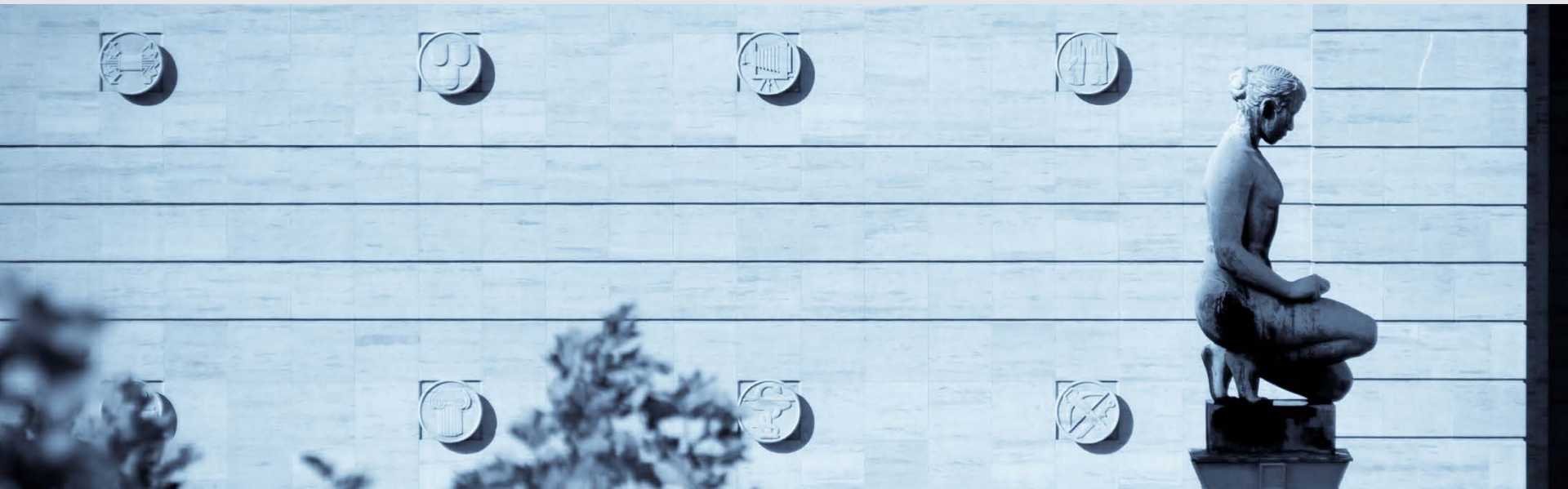


# Economic capital and risk appetite framework at National Bank of Belgium – A special case with private shareholders

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Etienne Lavigne  
Middle Office



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# 1. Central Bank and own funds

- In principle, own funds are not indispensable
  1. no bankruptcy;
  2. no illiquidity risk as banknotes issuance;
  3. future revenues from seigniorage as a first line
- But own funds are desirable (literature)
- Eurosystem : financial independence of NCBs
- Basel II regulations : not so helpful
- Central banks may have large risks
  1. FX reserves,
  2. Emergency Liquidity Assistance,
  3. Monetary policy non-standard measures.
- Role financial risks estimation.



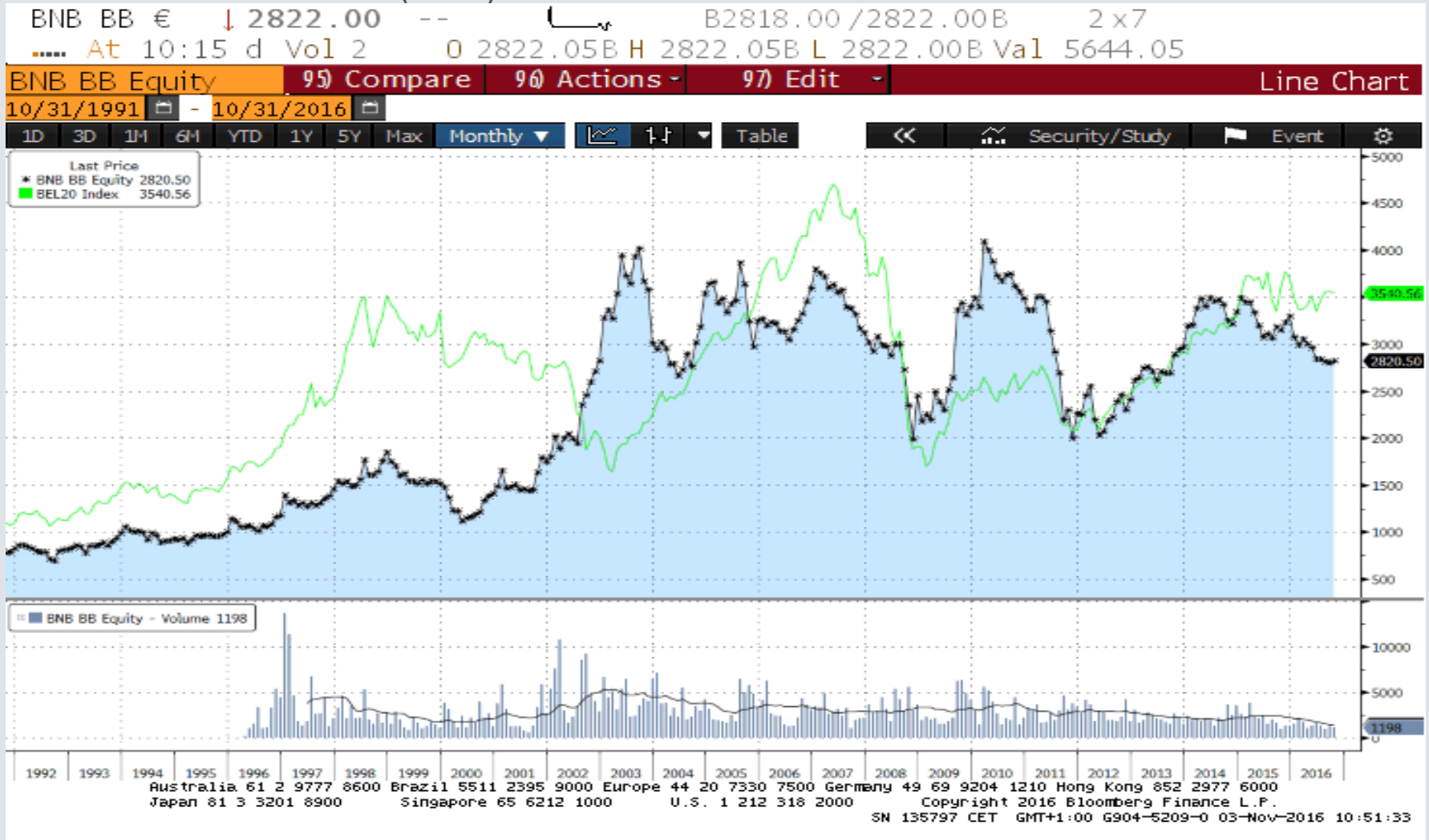
## 2. Special case of National Bank of Belgium

- NBB quoted on stock exchange
  - 50% state / 50% private shareholders
- Respect some rules as other enterprises “quoted” on the stock exchange / Public Limited Company
  - Communications, ordinary general meetings ...
- Fairness between the stakeholders
  - Central bank as authority
  - Central bank as enterprise
  - Shareholder
  - Sovereign state
- Link between reserves and dividend
- Link between reserves and risks
  - Impact of different missions (MonPol, Supervision, reserves management)
  - Eurosystem : less autonomy in risk management.



# 2.1. Quoted on stock exchange

- EUR 10 M (400,000 shares)
- 50 % / 50% others (1948)



## 2.2. Rules as PLC / Quoted

- Transparency
  - information on sales (real estate, ...), remuneration of directors, future projects, ...
  - accounting reporting following Eurosystem rules (but not IFRS)
  - all information with a potential impact on dividend
  - regulated info on result/profit
- General meeting of shareholders
- External control experts : external auditors
- Specific allocation of power (NBB vs PLC)



## ALLOCATION OF POWERS AT THE BANK AND IN PUBLIC LIMITED LIABILITY COMPANIES GOVERNED BY ORDINARY LAW

The Bank		Public limited liability companies governed by ordinary law	
<b>King</b>	<p>Appointment of the Governor</p> <p>Appointment of the Directors (on the proposal of the Council of Regency)</p>	<b>Appointment of the Directors</b>	<b>General Meeting</b>
<b>General Meeting</b>	<p>Election of the Regents (from a dual list of candidates)</p> <p>Election of the Censors</p> <p>Appointment of the auditor (on the proposal of the Works Council and with the approval of the EU Council of Ministers, on the recommendation of the ECB Governing Council)</p> <p>Hearing of the Annual Report</p> <p>Amendment of the Statutes except for Council of Regency prerogatives</p>	<p>Appointment of the auditors</p> <p>Hearing of the Annual report, auditors' report and discharge of the auditors</p> <p>Amendment of the articles of association</p>	
<b>Council of Regency</b>	<p>Amendment of the Statutes to bring them into line with the Organic Law and international obligations which are binding on Belgium</p> <p>Discussion and approval of the annual accounts</p> <p>Approval of the Annual Report</p> <p>Appropriation of the profits</p> <p>Discharge of the Board of Directors</p> <p>Setting the remuneration of the members of the Board of Directors</p>	<p>Discussion and approval of the annual accounts</p> <p>Appropriation of the profits</p> <p>Discharge of the Directors</p> <p>Setting the remuneration of the Board of Directors</p>	



The Bank

Public limited liability companies governed by ordinary law

	Approval of the budget
<b>Board of Directors</b>	<p>Definition of company policy</p> <ul style="list-style-type: none"> <li>- as central bank</li> <li>- as microprudential authority</li> <li>- as macroprudential authority</li> </ul> <p>Administration and management</p> <p>Drawing up of the annual accounts</p> <p>Preparation of the Annual Report</p> <p>Management and routine operation</p>
<b>Board of Censors</b>	<p>Supervision of the preparation and implementation of the budget</p> <p>Audit Committee</p>
<b>Sanctions Committee</b>	Pronounces on the imposition by the Bank of the administrative fines laid down by the laws applicable to the institutions that it supervises
<b>Resolution College</b>	Resolution authority authorised to apply the resolution instruments and to exercise the resolution powers
<b>Representative of the Minister of Finance</b>	Monitoring of the Bank's operations (right to oppose any measure which is contrary to the law, the Statutes or the interests of the State), except for those which come under the ESCB

Approval of the budget	<b>Board of Directors</b>
Definition of company policy	
Administration and management	
Drawing up of the annual accounts	
Drawing up of the Annual report	
Optional delegation of the management (Management Board) or the routine operation (Chief Executive)	<b>Management Board or Chief Executive</b>



# 3. Reserve policy

## 3.1. Objective

- Fairness (in particular for private shareholders)
- Transparency
- Stability

## 3.2. Balance sheet

9. Other assets		13. Capital and reserves	
9.3. Other financial assets	5177 M	13.1 Capital	10 M
		13.2 Reserve fund	2655 M
		13.3 Available reserves	2551 M



# 4. Reserve and dividend policy (since 2009)

## 4.1. Why a new policy ?

- Old rule
  - return on net assets of NBB:  
3% remains with NBB, (cover costs and shareholder remuneration)  
surplus for Treasury ( if 4.5% then 1.5% for Tr).
- Inadequate profit repartition as
  - Large increase of monetary basis during the 2000 years
  - Return under 3% as trend of lower rates
- Need of a better balanced system



# 4. Reserve and dividend policy (since 2009)

## 4.2. Dividend rule

- First dividend to shareholders
  - 6 % of capital = EUR 1,5 per share
- 25 % of profits to be allocated to the available reserve
  - min amount of reserves required in view of NBB risks
  - can result in transferring additional profits
- Second dividend to shareholders
  - 50 % of net proceeds of statutory portfolio (counterpart of total reserves)
  - guaranteed by available reserves (except if too low)
- Balance allocated to the state



# 4. Reserve and dividend policy (since 2009)

## 4.3. Impact of risks estimation

- Since 2016
  - 50 % of profits allocated to reserve (before 25%)
  - as long as the period of unconventional monetary policy persists
- Allocation of profits to reserve :
  - 25% allocation could be reduced (lower risks, ...)
  - Lower allocation (between 0% and 25%) depending on bank's profits relative to statutory portfolio profits

- Thus, key elements are
  - assessment of risks
  - level of profits
  - future risks



# 5. Financial risks and economic capital

- How to determine the appropriate level of capital / reserves ?
- = Level of financial risks
- How to evaluate those risks ?
- = ♦ Applying same concepts / methods for strategic asset allocation
  - ♦ With appropriate parameters for this goal



# 5. Financial risks and economic capital

## 5.1. Main principles

- Balance sheet approach
  - all assets / liabilities
  - direct and sharing risk with Eurosystem
- Long term approach
  - structural aspects of some policies  
(Held to Maturity portfolios, Monetary policy portfolios, ...)
  - special context, such as leverage effect of Eurosystem programmes
- Risk measures taking into account
  - characteristics of risk (tail, ...)
  - correlations



# 5. Financial risks and economic capital

## 5.2. Risks and methods

- Type of risks
  - FX, Interest, Credit
  - Long term market risk (leverage)
- Respect of accounting rules  
(asymmetry, specialization)
  - no diversification between FX, Interest, Credit
- Definition of a range
  - low level = min level of risk to be covered by reserves
  - high level = long term target for reserves



# 5. Financial risks and economic capital

## 5.3. Risk appetite

- Choice of parameters
  - low / high level of confidence
  - type of risk
  - other aspects

Risk	Measure	Horizon
FX	VAR 95/99 %	1 year
Interest	Min return 95/99 %	1 year
Credit	Low : VAR high prob High : ES high prob	1 year 1 year
Long Term	Probability to get a given average profit	Up to 5 years

- Probability levels are only indicative

