Twin Peaks. More than a new supervision model.

The new “twin peaks” supervision architecture for the Belgian financial sector will become effective on 1 April 2011. In short:

> the prudential supervision of most financial institutions will be in the hands of the National Bank of Belgium (the “NBB”) with, however, certain types of financial institutions with a lower risk profile still subject to prudential supervision by the Financial Services and Markets Authority (the “FSMA”\(^1\), which is the new name of the CBFA); and

> the supervision of the financial markets and of the so-called “conduct of business” (COB) rules will be concentrated in the hands of the FSMA.

The recently published Twin Peaks Royal Decree\(^2\) will have an important practical impact on the entire financial sector in Belgium.

The Belgian regulator did not limit itself to the adoption of a new twin peaks supervision model. It also took the opportunity of the Twin Peaks Decree to proceed with a general clean-up of existing financial legislation and, more importantly, to make a number of changes to existing legislation that are unrelated to the reform of the supervision architecture.

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In a first section, we analyse certain changes brought by the Twin Peaks Decree which are not related to the reform of the supervision model and which may have an impact on your business.

In a second section, we address, for the sake of completeness, certain other changes brought by the Twin Peaks Decree that we consider as being of secondary importance.

Finally, in a third section, we provide you with a high level overview of the new Belgian twin peaks supervision architecture and the new competences of the NBB and the FSMA.

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1. Autorité des services et marchés financiers / Autoriteit financiële diensten en markten.
1 Changes that may impact your business

1.1 Compliance officers to be approved by the FSMA

The Supervision Law of 2 August 2002 (the “Supervision Law”), as amended by the Twin Peaks Decree, introduces a new approval procedure for compliance officers.

The CBFA already issued a number of circulars with respect to compliance officers and their function. The approval requirement is, however, a novelty.

According to the Twin Peaks Decree, this obligation is introduced with a view to enhancing the quality control on compliance officers and their independent role within the financial institution.

The Twin Peaks Decree does not indicate whether this new obligation applies to compliance officers already in place. We expect a Regulation to be issued by the FSMA shortly on this point.

Non-compliance with this new obligation may lead to administrative sanctions, including fines of up to EUR 50,000.

1.2 FSMA assisted by auditors in the framework of its COB supervision role

The Twin Peaks Decree authorises the FSMA to “outsource” to external auditors the exercise of its new COB control functions (i.e. compliance with COB rules and adequate internal organisation related to COB rules). It will allow the FSMA to palliate any lack of internal resources and/or expertise.

This comes on top of the existing regime whereby the CBFA (and in the future the NBB and/or the FSMA) is authorised to request from statutory auditors of financial institutions that they execute special missions/inspections and report on the organisation, activities and structure of financial institutions.

Under the new regime, the FSMA can outsource supervisory control to any pre-approved Belgian external auditor. This is a major difference with the existing regime where special missions can only be given to appointed statutory auditors, to the extent such an external auditor has effectively been appointed.

The FSMA can make use of this new tool for routine supervision work. Surprisingly, nothing seems to prevent the FSMA from also relying on external auditors to investigate potential breaches of COB rules and, hence, assist it in regulatory investigations.

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3 Relevant for Belgian credit institutions, insurance companies, investment firms and fund management companies and Belgian branches of such non-EEA financial institutions.

4 Relevant for all Belgian financial institutions who are subject to Belgian MiFID-based conduct of business rules.
The powers of external auditors are very broad: they may request any type of document and information, they can make on-site inspections and must be granted access to all IT systems, etc. Although not indicated in the Twin Peaks Decree, it is likely that non-compliance with the injunctions/requests of an external auditor could lead to administrative sanctions and fines.

Unsurprisingly, the Twin Peaks Decree mentions that all costs in relation to the report of the external auditor will be borne by the relevant financial institution.

The use of external resources by the FSMA for the exercise of its supervision missions is questionable from a legal point of view and is likely to raise complex practical issues (conflict of interest, communication of confidential information, etc.).

It is expected that the FSMA will shortly issue Regulations in this respect.

1.3 **FSMA to charge a fee for the review of marketing documents**

Under the current regime, prior approval of marketing documents by the CBFA is a requirement when such marketing documents are produced in the framework of a public offer of investment instruments for which a prospectus is required or by investment funds (SICAVs, etc.).

It is likely that, in the near future – after adoption of a Royal Decree to that effect – most of the marketing documents produced by financial institutions doing business in Belgium (and not only those produced in the framework of a public offer) will have to be approved beforehand by the FSMA.

As in the future the FSMA staff is likely to devote a large part of its time to the review of marketing documents, the Supervision Law has been adjusted to allow the FSMA to charge a fee for the review of marketing documents, and, hence, ensure that its operating expenditures are adequately borne by the relevant financial institutions and/or issuers.

This will inevitably increase the costs related to the marketing of financial products and services in Belgium. We expect that a Royal Decree will be issued shortly with the new FSMA fee scale.

1.4 **Part of the new emergency measures no longer applicable to banks**

The Bank Law was amended in June 2010 with a view to reinforcing the emergency and rescue measures that the CBFA and the

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5 Relevant for all financial institutions whose business is subject to Belgian COB rules and issuers of financial instruments offered to the public in Belgium.

6 See Article 60 of the prospectus law of 16 June 2006.

7 See Articles 53, 131 and 136 of the funds law of 20 July 2004.

8 Relevant for Belgian credit institutions and Belgian branches of non EEA credit institutions.
Government can take to prevent the failure of a credit institution. Those measures are, in essence, twofold: (i) the possibility – for the CBFA – to freeze existing contractual obligations of credit institutions and (ii) in the most severe cases where Belgian and/or international financial stability is at risk, the possibility – for the Government – to force the sale of assets and/or expropriate shareholders of a failing credit institution. Comparable measures have been adopted in relation to insurance companies, investment firms, etc. For a high-level description of those new emergency powers, see our Alert of July 2010.

The Twin Peaks Decree, which transfers the prudential supervision of credit institutions (including the adoption of emergency measures) to the NBB has modified the text of the Bank Law which, surprisingly, no longer contains a reference to the right – for the NBB – to impose on credit institutions a freeze on the execution of its contractual obligations. This is even more surprising since this change is not justified in the report to the King of the Twin Peaks Decree and that the comparable measures included in the other prudential laws (for insurance companies, investment firms, etc.) remain unchanged.

Either this change is an unfortunate error or it is the consequence of a well thought-through decision. In the latter case, it would have been preferable to explain the reasons for this change in the Report to the King of the Twin Peaks Decree. In the absence of any such explanation we consider that this is indeed an unfortunate error.

1.5 No longer definition of “systemically important financial institutions” (SIFIs)

SIFIs are, since October 2010, subject to reinforced prudential supervision by the CREFS/CSRSFI. A definition of SIFI was introduced in the Supervision Law by the Twin Peaks Law of 2 July 2010. CREFS/CSRSFI published on its website a list of the financial institutions that qualify as SIFIs as defined in the Supervision Law and, hence, that are subject to the reinforced prudential supervision regime.

Under the new twin peaks regime, the supervision of SIFIs will be transferred from CREFS/CSRSFI to the NBB (see Section 3.2 below).
The Twin Peaks Decree abrogates the definition of SIFI. As from 1 April 2011, the NBB will be competent to determine – in its sole discretion – which financial institutions qualify as SIFIs.

The absence of an objective definition of SIFI gives more flexibility to the NBB in its new role as supervision authority in charge of macro-prudential supervision and of the stability of the financial system. However, on the other hand, this creates uncertainty for the – medium to large size – financial institutions that are currently not considered as SIFIs but could, at any time after 1 April 2011, be characterised as such by the NBB and, hence, be subject to an additional (and potentially burdensome and intrusive) layer of prudential supervision.

2 Other changes

2.1 Useful clarification on the MiFID supervision powers of the FSMA in relation to branches\textsuperscript{16}

The Supervision Law now helpfully clarifies that, in accordance with MiFID principles, Belgian COB rules do not apply to EEA branches of Belgian credit institutions and investment firms. The Report to the King of the Twin Peaks Decree provides useful practical explanation of the COB-based powers of the FSMA when investment services are provided on a cross-border basis and through a branch\textsuperscript{17}.

2.2 Injunctive reliefs by the Commercial Court in case of breach of Belgian COB rules\textsuperscript{18}

The Law of 4 December 1990 on financial transactions and financial markets empowers the President of the Commercial Court to issue injunctive reliefs (\textit{action en cessation / vordering tot staking}) to protect “public savings” against illicit activities. This comes on top of the administrative decisions that the NBB and/or the FSMA may take when they identify irregular or illicit behaviours and activities.

The Twin Peaks Decree has increased the powers of the President of the Commercial Court, which is now also authorised to issue injunctive reliefs in case of non compliance with Belgian COB rules.

2.3 Bank monopoly for the collection of public savings moved to the Public Offer Law\textsuperscript{19}

The general principle that only credit institutions are authorised to collect deposits and other repayable funds from the public in Belgium is currently set out in Article 4 of the Bank Law.

The Twin Peaks Decree moves this general principle (together with its many exceptions) to a new Chapter XIIbis (Article 68bis) of the Public

\textsuperscript{16} Relevant for Belgian credit institutions and investment firms.
\textsuperscript{17} See p. 15635 of the Belgian State Gazette of 9 March 2011.
\textsuperscript{18} Relevant for all Belgian and foreign financial institutions that are subject to Belgian MiFID COB rules.
\textsuperscript{19} Relevant to all undertakings persons collecting deposits and repayable funds, including by means of an issue of debt securities, in and/or from Belgium.
Offer Law of 16 June 2006. According to the Report to the King, this change is justified by the numerous exceptions to the monopoly, which makes it more natural to have this principle in the Public Offer Law than in the Bank Law.

The text of the new Article 68bis of the Public Offer Law slightly differs from Article 4 of the Bank Law. The territorial scope of application of the monopoly has been rephrased in the third paragraph of Article 68bis. Surprisingly, the French and the Dutch versions of that third paragraph do not seem to correspond. The French version of the text seems to have a broader scope of application than the Dutch version (which does not seem to cover situations where the solicitation is made in Belgium but from abroad). This is an unfortunate error that creates unwelcome uncertainty.

3 The twin peaks supervision model

3.1 Milestones of the reform of the Belgian supervision architecture

The Twin Peaks Law of 2 July 2010\(^{20}\) is silent on the outlook of the future twin peaks supervision architecture and the sharing of powers between the NBB and the CBFA. All the details of the new architecture are contained in the Twin Peaks Decree\(^{21}\).

The main purpose of the reform is to move away from a centralised supervision model – which is no longer considered in Europe as the optimal model – and to adopt a bi-polar financial supervision structure where supervision powers are shared between the NBB and the FSMA.

As set out above, the new Belgian supervision model of the Twin Peaks Decree will enter into force on 1 April 2011.

However, the Twin Peaks Royal Decree provides that, to ensure a smooth transition, certain elements of the reform will not take place immediately. The following reorganisations are due to take place, by separate Royal Decree, at the latest by 31 December 2015:

(i) the transfer of supervisory powers from the Securities Regulation Fund (Fonds des Rentes / Rentefonds) to the FSMA in relation to the supervision of the Belgian Government Bonds Market (see footnote 24 below); and

(ii) the increase of the powers of the FSMA with respect to the supervision of consumer credit undertakings and transactions (see Section 3.3 below).


\(^{21}\) Which has been adopted in application of the – extensive – delegation of powers contained in Article 26 of the Twin Peaks Law.
3.2 The competences of the NBB

The Twin Peaks Decree significantly increases the powers of the NBB. Under the new supervision model the NBB will, among others, be responsible for:

(i) The **macro-prudential supervision** of the financial sector\(^{22}\):
    (a) identification of threats for the stability of the financial sector, (b) advice to the Parliament and the Government on measures to be taken to maintain financial stability an to ensure the good functioning of the Belgian financial system, (c) coordination of financial crisis management, etc.;

(ii) The reinforced **supervision of systemically important financial institutions** (“SIFIs”) – which is currently handled *ad interim* by CREFS/CSRSFI: (a) supervision of “strategic decisions” envisaged by SIFIs and right to oppose such strategic decisions if they create a material risk for the stability of the financial sector, (b) right to impose additional specific measures to SIFIs, including in relation to liquidity, solvability, concentration of risks, etc. if necessary to ensure stability of the financial system, etc.;

(iii) The **micro-prudential supervision** of most of the Belgian financial institutions that are currently supervised by the CBFA, including:
    - credit institutions;
    - insurance and reinsurance companies;
    - MiFID brokers (*sociétés de bourse / beursvennootschappen*);
    - settlement institutions and clearing institutions;
    - e-money and payment institutions.

The prudential powers of the NBB in relation to the above financial institutions include the supervision of all aspects related to capital, liquidity and solvency requirements, internal governance and organisation, fit & proper assessment of management and shareholders, etc.

The NBB will be empowered to take administrative measures and, through the NBB Sanctions Commission, impose administrative sanctions in case of non-compliance with applicable prudential regulation.

3.3 The competences of the FSMA

Under the new supervision model the NBB will, among others, be responsible for:

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\(^{22}\) Under the current regime, the NBB is already in charge of the macro-prudential supervision of the financial sector. The Twin Peaks Decree further clarifies and reinforces its role as macro-economic supervision authority.
(i) The **micro-prudential supervision** of the financial institutions that are not subject to NBB supervision, including:

- MiFID portfolio management and investment advice companies (*sociétés des gestion de portefeuille et de conseil en investissement* / *vennootschappen voor vermogensbeheer en beleggingsadvies*);
- fund management companies and collective investment undertakings;
- foreign exchange offices (*bureaux de change* / *wisselkantoren*);
- mortgage credit undertakings and consumer credit undertakings\(^{23}\);
- insurance and reinsurance intermediaries, intermediaries in bank- and investment services;
- institutions for occupational pensions.

As is the case with the NBB, the prudential powers of the FSMA in relation to the above financial institutions include the supervision of all aspects related to capital requirements, internal governance and organisation, fit & proper assessment of management and shareholders, etc.

(ii) The **supervision of financial markets**, including the control of financial products (public offers, listings, takeover bids, etc.), the control of information to the market by listed companies and market abuse\(^{24}\).

(iii) The **financial education of investors and their protection** against the illicit provision of financial products and services.

(iv) The **supervision of conduct of business (“COB”) rules** by financial institutions, regardless of whether they are subject to prudential supervision by the NBB or the FSMA.

Currently, the main sources of COB rules are Articles 27 (conduct of business obligations), 28 (best execution) and 28bis (general obligation to act honestly, fairly and professionally and in an manner which promotes the integrity of the market) of the Supervision Law and the MiFID implementing Royal Decree of 3 June 2007.

The ultimate objective is to ensure that all financial institutions offering financial services are subject to a comprehensive set of common COB rules, under the supervision of the FSMA.

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\(^{23}\) The transfer of the supervision of consumer credit undertakings to the FSMA will, however, place at a later stage – see Section 3.1(ii) above.

\(^{24}\) The Twin Peaks Decree also organises the transfer to the FSMA of the supervision of the Belgian government bond market, which is currently in the hands of the Securities Regulation Fund (*Fonds des Rentes / Rentefonds*). This transfer of powers is, however, not for the immediate future (see Section 3.1(i) above).
In light of this ultimate objective, we anticipate that Belgian COB rules will undergo significant changes in the nearby future, including:

(a) the adoption of additional COB rules with a view to further detailing/regulating pre-contractual and contractual information obligations, the obligation to serve the client in the best possible manner, inducements, the provision of financial services through the Internet, the marketing of financial products and services, etc.; and

(b) the extension of COB rules to the entire spectrum of financial institutions and intermediaries, including insurance companies, insurance and reinsurance intermediaries and intermediaries in bank and investment services.

The FSMA will be empowered to take administrative measures and, through the FSMA Sanctions Commission, impose administrative sanctions in case of non-compliance with the above rules.

3.4 In practice

As a consequence of the new division of powers, financial institutions subject to Belgian supervision will be faced with new supervisors, new procedures etc. Most of the large financial institutions will have to deal, simultaneously, with the NBB and the FSMA for their day-to-day activities.

The Twin Peaks Decree does not address in great detail how the NBB and the FSMA will cooperate in the future. A Memorandum of Understanding (MoU) will, in principle, be entered into shortly (hopefully before 1 April 2011) between the NBB and the FSMA in this respect. It should clarify the many outstanding practical questions that are not addressed by the Twin Peaks Decree.

The Council of State suggested that the Report to the King be accompanied by a recapitulative table of the changes to existing legislation. The suggestion of the Council of State was not followed but, instead, the Report to the King indicates that the NBB and the FSMA will take all possible measures to publish on their respective websites, on 1 April 2011, a coordinated version of the various laws affected by the Twin Peaks Decree. Those consolidated texts will indeed prove a useful tool to better grasp and understand the architecture of the new Belgian supervision model.

Authors: Etienne Dessy and Els Janssens

25 An extension of the MiFID-based COB rules to other financial sectors can be decided by the King pursuant to the new Article 281ter of the Supervision Law, inserted by the Twin Peaks Law.