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The regulation and supervision of the Belgian financial system (1830 - 2005)

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SEEMHN

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Editorial

The South-Eastern European Monetary History Network (SEEMHN) is a community of financial historians, economists and statisticians, established in April 2006 at the initiation of the Bulgarian National Bank and the Bank of Greece. Its objective is to spread knowledge on the economic history of the region in the context of European experience with a specific focus on financial, monetary and banking history. The First and the Second Annual Conferences were held in Sofia (BNB) in 2006 and in Vienna (OeNB) in 2007. Additionally, the SEEMHN Data Collection Task Force aims at establishing a historical data base with 19th and 20th century financial and monetary data for countries in the region. A set of data has already been published as an annex to the 2007 conference proceedings, released by the OeNB (2008, Workshops, no 13).

On 13-14 March 2008, the Third Annual Conference was held in Athens, hosted by the Bank of Greece. The conference was dedicated to *Banking and Finance in South-Eastern Europe: Lessons of Historical Experience*. It was attended by representatives of the Albanian, Austrian, Belgian, Bulgarian, German, Greek, Romanian, Russian, Serbian and Turkish central banks, as well as participants from a number of universities and research institutions. Professor Michael Bordo delivered the key note speech on *Growing up to Financial Stability*. The participants presented, reviewed and assessed the experience of SE Europe with financial development, banking and central banking from a comparative and historical perspective.

The 4th Annual SEEMHN Conference will be hosted by the National Serbian Bank on 27th March 2009 in Belgrade. The topic of the Conference will be *Economic and Financial Stability in SE Europe in a Historical and Comparative Perspective*.

The papers presented at the 2008 SEEMHN Conference are being made available to a wider audience in the Working Paper Series of the Bank of Greece. Here we present the fourth of these papers, by Erik Buyst and Ivo Maes.

June, 2008

Sophia Lazaretou
SEEMHN Coordinator
Member of the Scientific and Organizing Committee

THE REGULATION AND SUPERVISION OF THE BELGIAN FINANCIAL SYSTEM (1830-2005)

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ABSTRACT

This paper provides an overview of the regulation and supervision of the Belgian financial system from the creation of Belgium in 1830 to the early 21st century. After severe crises, the National Bank of Belgium was created in 1850. The Great Depression led to further reforms, increasing the role of the government, especially through the establishment of the Banking Commission. In the post-war period, reforms were driven by changes in the financial landscape, especially an increasing role for market forces. In line with the despecialisation process, the responsibilities of the Banking Commission were gradually extended, becoming, in 2004, the Banking, Finance and Insurance Commission. Moreover, at the turn of the millennium, the role of the NBB in financial stability matters was enhanced.

Keywords: Financial regulation; Financial supervision; Belgium.
JEL classification: G18; N23; N44.

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1. Introduction

Banking crises are of all times, but their origin has changed considerably through the years. In the 19th century, the breakthrough of banknotes into a hitherto metallic monetary system raised the issue of the convertibility of paper money into specie. In the 1830s and 1840s, Belgium was shaken by severe convertibility panics. How did the government respond to these crises? What kind of long-term institutional arrangements were imposed?

Once the convertibility problem was under control, banking crises took the form of liquidity and/or solvency shocks that we still know today. Although Belgium was hit by severe financial panics in the 1870s and 1880s, no structural reforms were imposed. It was only during the Great Depression of the 1930s that new institutional arrangements for the regulation and supervision of the Belgian financial system were tried out. The highly interventionist framework that resulted proved successful. In the post-war period, serious reforms were necessary to deal adequately with the rapidly changing financial landscape as market forces were gaining in importance.

The paper starts with a short exploration of the concept of financial stability. Thereafter, we follow a chronological approach, focusing on the institutional reforms of the 1840s, the 1930s and the last decades of the 20th century.

2. An Exploration of the Concept of Financial Stability

There is a broad consensus that financial stability is one of the more difficult and elusive concepts in economics (Oosterloo and de Haan, 2004). However, there is also general agreement that there are reasons for caring more about stability in the financial sector, especially banking, than in any other industry (Lamfalussy, 1988). First, banks are highly leveraged institutions, with long-term assets and short-term liabilities, making them more vulnerable. Second, the failure of individual financial institutions can lead to chain reactions within the system because of the strong links tying institutions to each other. The speed at which funds can be shifted and the role of expectations are important elements here. Third, owing to the central place of financial institutions in the mechanism of credit allocation and in the payments system, whatever happens in the financial system can have far-reaching consequences for the real economy.

It is generally accepted that monetary stability is a necessary condition for financial stability. However, financial crises can also occur in periods when money is stable. Special attention has therefore been paid to banking crises. Banks can run into trouble both because of liquidity and solvency problems. Liquidity shocks tend to have their origin in the withdrawal of deposits by customers, while solvency shocks arise from losses on banks' (long-term) investments.

Naturally, financial stability is an important concern for policy-makers (Maes and Périlleux, 1993). In modern day literature, two main objectives can be distinguished: the protection of small depositors and the avoidance of a systemic crisis. Defining a systemic crisis is by no means simple. Broadly speaking, one could characterise it as a situation where a crisis in the financial sector has a large-scale impact on the real economy (Lamfalussy, 2003). For safeguarding financial stability, two types of policy are crucial: (a) *ex ante* preventive actions, especially regulation and supervision, which make it less likely those crises will occur, strongly focused on the solvency of financial institutions, and (b) crisis management, especially the identification and resolution of crises (EFC, 2001, Mayes, 2004, Vaillant and Amouriaux, 1998).

3. The 19th Century: the Creation of the NBB

In the early 1830s, Belgium stood at the cradle of universal banking. By that time, the Société Générale not only issued paper money, provided discount credit for commercial purposes and operated a savings bank, but also invested intensively in the share capital of manufacturing firms (Laureyssens, 1975; Kindleberger, 1993). The new formula proved very successful and soon a similar rival was established, the Banque de Belgique. In the second half of the 1830s, both universal banks dominated the Belgian financial landscape and competed fiercely. The two banks soon found them running serious risks as their working capital became increasingly tied up in claims that were difficult to realise in crisis periods, such as shares and camouflaged long-term loans to industry. In 1838 and 1848, severe financial panics broke out: the public demanded repayment of deposits and the conversion of banknotes into gold and silver coins. In both crises, at least one of the two big universal banks was no longer able to redeem its banknotes and the government had to intervene as a *de facto* lender of last resort (Chlepner, 1926).

Tired of the structural weaknesses of Belgium's banking system, Finance Minister Walthère Frère-Orban pushed through major reforms. In the 1850-1865 period, he gradually split up the various activities of the universal banks and assigned them to separate, specialised financial institutions. The centrepiece of the reforms was the setting up in 1850 of a national discounting and issuing institute along the lines of the Banque de France. The Société Générale and the Banque de Belgique therefore had to surrender their right of issue and most of their discount activities to a new institution, named *Banque Nationale*[1]. In 1860, the Finance Minister founded the *Crédit Communal* to provide loans to local authorities. Moreover, in 1865, Frère-Orban pushed through the establishment of a specialised public savings bank, the *Caisse Générale d'Epargne et de Retraite* (CGER). The CGER soon became the largest player in this segment (Van der Wee and Verbreyt, 1997). As a result, the Société Générale and Banque de Belgique had to confine themselves to industrial investment activities and became *banques d'affaires.*

The law of 5 May 1850 and the statutes define the principal tasks and structure of the National Bank of Belgium (NBB). In view of the 1838 and 1848 crises, it comes as no surprise that the NBB's main task was to maintain convertibility of its banknotes in specie. So the legislator confined the NBB's activities largely to discount operations linked to commercial transactions. The bills of exchange normally had to bear three solvent signatures and reach maturity within 100 days. The NBB was also authorised to discount foreign bills of exchange.

The legislator clearly feared that the government could use the NBB to finance public spending. Therefore, the NBB was allowed to invest in government bonds, but only to an amount not exceeding its own capital and reserves. In addition, there were strict limits on the discount of Treasury notes. Government securities were admitted as collateral but only for an amount not exceeding 80 percent of their market value. Finally, the NBB was not permitted to grant loans against the collateral of shares or

1 In 1900, the name was officially changed into *Banque Nationale de Belgique/Nationale Bank van België*. As the institution today still carries that name, we use the term National Bank of Belgium or NBB for the 19th century too.

mortgages. Nor could it acquire property – except for its own use – or invest in industrial corporations (*Moniteur belge*, 16 May 1850 and 5 September 1850).

Frère-Orban's reforms restricted the leverage of the Belgian banking sector and the effects were clearly visible on the convertibility front. The NBB managed to maintain the conversion of banknotes in specie during most international monetary-financial crises of the second half of the 19th century (Buyst, Maes and Pluym, 2005).

However, Frère-Orban's ambitions went further than just promoting monetary stability. During debates in Parliament, he nurtured the hope that, in times of financial turmoil, the NBB would maintain its discount activities in order to alleviate the impact of any future crisis: *"Elles [discounting and issuing institutes] doivent enfin être organisées de manière à pouvoir venir au secours du pays dans les moments difficiles, atténuer les effets des crises, en escomptant à des taux raisonnables quand les capitaux deviennent rares. Loin d'être une cause d'embarras, elles doivent contribuer à diminuer l'intensité des crises"*[2]. This pointed to the concept of *lender of last resort,* but neither the law establishing the NBB nor its statutes contain articles that can be read as such.

Did the NBB fulfil Frère-Orban's promise in practice? Before looking at the historical facts, we have to mention that the late 1860s and early 1870s were characterised by an important shift in the structure of Belgian banking. Inspired by the English example, the Société Générale introduced interest-bearing current accounts to stimulate the use of demand deposits, giro payment systems and cheques. The success of the demand deposits/advances in current account tandem on top of the Société Générale's traditional investment bank operations marked a spectacular rebirth of universal banking in Belgium. In parallel, there was a reappearance of the risk that a bank's working capital could become largely tied up in claims that were difficult to realise in crisis periods, such as shares and loans to industry, while their liabilities – mainly demand deposits – could be withdrawn at short notice.

When analysing the several banking crises that struck Belgium, especially in the difficult 1870s and 1880s, the following general picture emerges. First, whether or not a rescue operation was set up depended very much on the personality of the Finance Minister. A case in point was the severe 1885-1886 panic which was allowed to rage on. Ultimately, more that 20% of total paid-up capital in the Belgian banking sector went up in smoke (Durviaux, 1947).

Second, if the Finance Minister decided to intervene, he usually set up a consortium of financial institutions to keep the bank in difficulty afloat. When the ailing bank specialised in supplying discount credit, the Finance Minister usually asked the NBB to join the effort, but the NBB's specific role varied considerably from case to case.

When a crisis hit universal or investment banks, the Finance Minister did not ask the NBB for help. Most universal banks' collateral consisted of shares and industrial loans, while bills of exchange and government securities made up only a modest part of their total assets (Durviaux, 1947). As indicated earlier, the NBB was only allowed to provide liquidity against the last category of collateral. Moreover, the NBB's first duty was to maintain convertibility of banknotes. So its financial capacity to participate in rescue operations was relatively limited, especially in cases where a banking crisis coincided with monetary unrest. Therefore, the Finance Minister usually asked the Société Générale, Belgium's most important (universal) bank, to take up a pivotal role in arranging lifeboat operations. The Société Générale often responded in a positive way to such requests. Prestige reasons certainly help to explain this activist stance, but the bank also made sure that the State bore most of the financial risks involved.

For the second half of the 19th century, we have to conclude that the NBB cannot be considered as a lender of last resort, in the sense of taking responsibility for the stability of the financial system. The Finance Minister played a far more important role, while the Société Générale was involved in most rescue consortia (Buyst and Maes, 2008).

4. The Interwar Period

Between the last decades of the 19th century and the early 1930s, little changed: Belgium remained a very liberal country with no specific legal controls over private financial institutions. Even a system of standardised accounting practices was

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2 Exposé des motifs… (*Lois organiques, statuts…*, p. 51).

missing. Banks – and other limited liability corporations – continued to publish their annual balance sheets in the format they wished. In this way, the effects of possible mismanagement could relatively easily be disguised.

4.1 The Great Depression

Being a small open economy, Belgium was seriously hit by the Great Depression. The general slump in world demand and the spread of various forms of protectionism soon strangled exports. Things became even worse as the Belgian government decided in September 1931 not to follow the British pound's abandonment of gold convertibility. The subsequent steep depreciation of sterling dealt a heavy blow to Belgium's competitive position on world markets, all the more so as two-thirds of Belgian foreign trade was paid for in sterling.

The government responded to these problems by launching a deflation policy. Reducing domestic prices and costs would once again bring them into line with the lower world market level. However, this proved to be much more difficult than anticipated. In the case of public finances, the government did not succeed in pushing through sufficient austerity measures so that substantial budget deficits kept on popping up. The government often resorted to tax increases that, in one way or the other, pushed up production costs. The reduction in nominal wages also encountered fierce resistance, so that the intended alignment of Belgian prices with the world market level made only painfully slow progress. So, in the sectors exposed to international competition, business closures and downscaling of operations continued unabated (Buyst, 2004).

For many Belgian banks, this was bad news. They often had substantial shareholdings in export-oriented producers of semi-finished goods – steel, non-ferrous metals, glass – precisely the categories hardest hit by the world depression. To survive, these companies needed additional loans. There was immense pressure on the universal banks to put more money on the table, because if a company which it controlled went bankrupt, the financial institution would lose both the stake in the firm and the loans granted (Van der Wee and Verbreyt, 1997). Moreover, no-one could foresee that the economic malaise would drag on for so long. The outcome was inevitable: soon the companies could no longer repay their additional borrowings either, which in turn undermined further the liquidity position of the universal banks. Nor could the financial institutions cash in their share portfolio without incurring heavy losses, because of the persistently steep fall in share prices.

As early as 1930, Belgium was shaken by a number of bankruptcies in the export industry. The Banque de Bruxelles, which had pursued a policy of aggressive expansion in the late 1920s, was one of those to suffer heavy losses. When a number of medium-sized banks suspended their payments in 1931-1932, the public began to withdraw deposits, causing a further deterioration in the liquidity position of financial institutions.

The NBB repeatedly set up rescue operations to help banks suffering payment difficulties, but its capabilities were constrained by the strict provisions of its statutes. For example, it was not allowed to rediscount industrial loans, often the most important collateral of universal banks. Also, as a private company, the NBB was very concerned about the satisfactory conclusion of the operations financed. Once all acceptable securities owned by a financial institution with liquidity problems had been pledged, the NBB mercilessly turned off the supply of credit (Van der Wee and Tavernier, 1975). Moreover, the financial crisis rapidly grew to such proportions that a central bank acting alone could no longer save the system. Yet there were some inconsistencies in the actions taken by the NBB. In a climate of falling prices, it kept the nominal discount rate at a relatively high level, compared with France, for example. Such an interest rate policy was unlikely to alleviate the financial distress of the banking sector.

4.2 The reform of 1934: the separation of deposit banks and holding companies

In March 1934, the financial crisis reached a first peak with the bankruptcy of the *Banque Belge du Travail*. When it emerged that this institution had used deposits to acquire shares in companies, a storm of indignation erupted among the population. The savings of small depositors had been used to finance very risky operations[3]. Also,

3 In fact, the *Banque Belge du Travail* was the big exception. Most Belgian universal banks financed portfolio operations with their own capital and reserves.

the oligopolistic practices of some large financial institutions[4] and their grip on Belgian politics were highly criticised. In such a climate, the socialist demand for nationalisation of the sector found an ever more receptive audience.

A new wave of deposit withdrawals plunged the banks still deeper into the mire, so that urgent action by the government was needed to avoid a collapse of the financial system. However, the government realised that public opinion would only accept a large-scale rescue operation for the banks if the sector underwent an accompanying and radical structural reform. So on 22 August 1934, two important Royal Decrees were passed simultaneously (*Moniteur belge*, 24 August 1934).

The first Decree authorised the banks to exchange sound but frozen claims on industry for bonds issued by the *Société Nationale de Crédit à l'Industrie (SNCI)*, up to a maximum of 2 billion francs[5]. Since those bonds were backed by State guarantee, they could be presented to the NBB for discounting. However, it took several months for all practical problems to be solved and the system to become fully operational. The measure improved the liquidity of banks, but it was a case of "too little, too late". A rough estimate indicates that at least double the amount had to be injected to really get the banking system afloat again. But such an effort was of course not reconcilable with a deflation policy (Van der Wee and Tavernier, 1975).

The second Decree required the universal banks to split into two separate institutions: a pure deposit bank and a holding company. According to the government, the new structure guaranteed protection for small savers. Separating the management of deposits from the acquisition of shares in companies greatly reduced the risk of liquidity problems in the banking sector. Moreover, it became more difficult for (deposit) banks to hide losses behind complex portfolio operations. Finally, a system of standardised accounting practices was imposed on the deposit banks. The government hoped that these measures would restore people's confidence in the banking system and that the withdrawal of deposits would automatically cease.

4 In the early 1930s, the *Société Générale* alone controlled 100% of the Belgian copper industry, 60 to 75% of the zinc industry, about 50% of the iron and steel sector, 40% of the glass industry, etc. (van der Valk, 1932). *Société Générale* and *Banque de Bruxelles* together accounted forabout 50% of all banking assets in Belgium.

5 The *Société Nationale de Crédit à l'Industrie/Nationale Maatschappij voor Krediet aan de Nijverheid* (SNCI) was set up in 1919. Its main purpose was to grant industrial credit on medium and occasionally on long term primarily to medium-sized firms. The SNCI financed these operations by issuing bonds and notes backed by State guarantee (Vandeputte, 1961).

The new legal framework was clearly inspired by the British banking system and its high degree of specialisation. The relative absence of major financial crises in Britain had impressed contemporaries throughout the Western world. Before Belgium, countries such as Italy and the United States had taken similar measures to separate investment and deposit activities (De Barsy, 1960; Toniolo, 1995).

Remarkably, Belgian bankers did not protest loudly against these radical reforms. Quite to the contrary, detailed archival research has demonstrated that the big universal banks, and especially the *Société Générale*, had largely developed the whole scenario themselves (Vanthemsche, 1997). This, of course, begs the question why? First, the operation appeased public opinion, since splitting the universal banks was perceived as a kind of punishment for big capital. So, the threat of nationalisation disappeared from the political agenda once again. Second, the major restructuring opened opportunities for banks to write off a sizeable part of their losses in an almost unnoticeable way (Baudhuin, 1935; De Barsy, 1960).

4.3 The final crash?

The government's illusions were soon shattered. At the end of 1934, rumours started circulating that the *Algemeene Bankvereeniging* and the *Middenkredietkas* – the savings bank of the Belgian Farmers League – were on the point of closing their doors. Again the government launched a large-scale rescue operation (Goossens, 2002), but this could not prevent the outbreak of a general crisis of confidence. People not only rushed to financial institutions to withdraw their deposits en masse. In addition, the government's deflation policy lost all credibility as it seemed to cause nothing but financial crises and unemployment. The spectre of massive capital flight reared its head, rendering the position of the Belgian banking system still more precarious. On international currency markets, the franc soon came under heavy attack from speculators. If a financial catastrophe was to be avoided, an immediate turnaround was essential.

March 1935 brought a radical upheaval on the Belgian political scene. King Leopold III asked the NBB's vice-governor, Paul van Zeeland, to form a government of national unity. Once van Zeeland was appointed prime minister, he immediately devalued the franc by 28%. In the short run, the devaluation of the franc was certainly beneficial to the Belgian economy. It restored the competitiveness of Belgian firms, so that they were able to take full advantage of the revival in international economic activity which got under way in the mid-1930s. Moreover, large amounts of capital flowed back into the country, immediately solving the banks' liquidity problems.

The near collapse of the financial system in late 1934 and early 1935 had shown that dividing up the universal banks was not sufficient to restore confidence in the sector. Policy-makers had realised that financial institutions fulfilled crucial functions in the public interest: they managed the national savings and credit system, and they created bank money which determined to a considerable degree the performance of the rest of the economy. Therefore, the government decided to regulate the activities of the sector and to bring the private financial institutions under State supervision[6].

4.4 The structural reforms of the second half of the 1930s

The structural reforms of the second half of the 1930s can be divided into four categories. First, all private financial institutions that received deposits with a maturity of less than two years had to be recognised by the government either as a deposit bank or as a savings bank (see Table 1). The new legal framework clearly favoured a specialised financial system. Savings banks could only develop those activities which were explicitly permitted by law. So they had to invest at least 60% of their deposits in long-term assets, mainly government securities and mortgage loans. On the contrary, deposit banks were – in principle – entitled to engage in any financial activity unless explicitly forbidden. Stakes in non-banking companies, for instance, remained prohibited. From the mid-1930s, deposit banks focused their lending activities on short-term credit to industry in order to maintain their liquidity. This *de facto* specialisation corresponded to the legislator's philosophy. Long-term financing of industrial projects became the field of holding companies and the SNCI (Durviaux, 1947).

Second, new institutions were established to organise state supervision. In the case of savings banks, the *Office Central de la Petite Epargne* (OCPE) was set up. The OCPE was *de facto* a subdivision of the National Bank of Belgium: The governor of

[6] Rapport au Roi, Royal Decree No. 185 of 9 July 1935 (*Moniteur belge*, 10 July 1935).

the NBB chaired the OCPE and the office was housed in the NBB's premises (Goossens, 2002). Much more important, however, was the establishment of the Banking Commission, inspired by the Swiss example (Vanthemsche, 1980). Among other things, the institution had the power to require deposit banks to maintain certain ratios: a liquidity ratio – the ratio between assets that can be readily realised and short-term deposits – and a solvency ratio – the ratio between equity capital and the total volume of deposits. The Banking Commission, in consultation with the NBB, could also set maximum interest rates for certain categories of lending. Via a network of independent, certified auditors, the new institution also coordinated the supervision of each individual bank's activities.

Prime Minister van Zeeland had intended the Banking Commission to function under the aegis of the NBB but, in the end, that hope was frustrated. After fierce lobbying by the major deposit banks, fearing an excessive concentration of power, the Banking Commission was set up as an independent public institution. Nevertheless, the government aimed at close cooperation between the two: the NBB would concentrate on credit policy and the Banking Commission would focus on the protection of savers. At first, there was little sign of any such cooperation, but things changed in the late 1930s.

Table 1 - Belgium's financial system by the end of the 1930s

	Private financial institutions		Public credit institutions
	Savings banks	Deposit banks	
Statute	Royal Decree No. 42 of 15 December 1934	Royal Decree No. 185 of 9 July 1935	Law or Royal Decree of their foundation
State supervision	*Office Central de la Petite Epargne (OCPE)*	Banking Commission	Government
Lender of last resort	National Bank of Belgium (NBB) and since 1935 also *Institut de Réescompte et de Garantie (Rediscount and Guarantee Institute, RGI)*		Government

Sources: *Moniteur belge*, 16 December 1934, 10 July 1935, 11 November 1937 (Royal Decree of 22 October 1937).

Third, the government improved the access of financial institutions to emergency liquidity. As indicated above, the NBB's capabilities to help banks facing payment difficulties during the crises of 1934 and early 1935 had been constrained by the strict provisions of its statutes. Inspired by the German example, the government established the *Institut de Réescompte et de Garantie* (Rediscount and Guarantee Institute or RGI) that would mobilise at favourable conditions medium-term paper that did not qualify for discounting by the NBB. More specifically, the RGI focused on discounting bank loans to industry. The official justification for setting up a separate institution was that, particularly during financial panics, the NBB should remain the guardian of monetary orthodoxy. Therefore, it should only discount high-quality short-term bills of exchange and government securities (*Moniteur belge*, 14 June 1935; Van der Wee and Tavernier, 1975). A more plausible hypothesis, however, is that the socialist coalition partner mistrusted the NBB, i.e. because it was a private company. The socialists clearly wished to vest greater powers in public institutions, such as the RGI. Be that as it may, it was not long before the NBB and the RGI were working in close partnership.

Fourth, various initiatives were taken to reinforce the role of public credit institutions (PCI). In 1936, the *Office Central de Crédit Hypothécaire* was established to mobilise mortgage claims and to put downward pressure on mortgage rates. The following year, the government tightened its grip on the *Société Nationale de Crédit à l'Industrie* and set up new specialised PCIs to provide credit to small businesses and farmers (see table 2). Although the role of these newcomers remained limited before the Second World War, their competences often overlapped with those of existing PCIs which soon created tensions. Moreover, many private financial institutions complained bitterly about unfair competition from the public credit institutions as a whole and the CGER in particular (Vanthemsche, 1997; Goossens, 2002). After the financial panics of the mid-1930s, many depositors felt more at ease being a client of an institution backed by the State.

Table 2 - Public credit institutions by the end of the 1930s

Name	Date of establishment
Crédit Communal	Royal Decree of 8 December 1860
Caisse Générale d'Epargne et de Retraite (CGER)	Law of 16 March 1865
Société Nationale de Crédit à l'Industrie (SNCI)	Law of 16 March 1919
Caisse Centrale du Petit Crédit Professionnel	Law of 11 May 1929
Office Central de Crédit Hypothécaire	Royal Decree No. 226 of 7 January 1936
Institut Nationale de Crédit Agricole	Royal Decree of 30 September 1937
Caisse Nationale des Classes Moyennes	Royal Decree of 14 October 1937

Did these measures help to stabilise the Belgian financial system? Between mid-1937 and September 1938, deposits fell by about a quarter because of a new international recession and the growing threat of war (Commission Bancaire, *Rapports annuels*, 1937-1938). Despite this new onslaught, only a few deposit banks ran into difficulties. In the case of the Crédit Anversois, the RGI tried to arrange a rescue operation, but in vain. After the bank's failure, the RGI provided advances to Crédit Anversois depositors (Baudhuin, 1946).

5. The Second Half of the 20th Century

In the post-war period, there were no major banking crises in Belgium. There were a few bankruptcies of small banks, mostly because of fraud. There were also a few other incidents, like significant foreign exchange losses in a major bank in the first half of the 1970s (due to open positions) and problems with the Office Central de Crédit Hypothécaire. So, reforms in the institutional framework for banking supervision were not driven by crises, like in the interwar period, but rather by changes in the financial landscape, characterised by the growing role of market forces.

5.1 The financial sector at the end of the war

After the Second World War, the financial sector was regarded as a special sector, in which the government had an important role. This was to a large extent a legacy of the interwar period, when bank runs, stock market crashes and the Great Depression had led to significant government intervention in the financial system. Crucial objectives of the government were the protection of small savers and the prevention of systemic financial crises (Maes, 2007). The government intervened in a multitude of ways: different forms of regulation, the creation of institutions which were responsible for the supervision of the financial sector (Banking Commission) and government financial institutions providing financial services. The situation was not only typical for Belgium but for most countries in Europe. It was concisely summarised in a Report for the European Commission: "*Les choix des pouvoirs publics sont pour l'essentiel à l'origine de la répartition de la demande de moyens de financement ... Le volume fixé aux investissements publics, la fonction centrale remplie par les intermédiaires financiers à caractère public, la position dominante des administrations publiques sur le marché financier ne laissent en définitive subsister qu'un domaine relativement restreint où la répartition des ressources s'effectue à travers les mécanismes de marchés traditionnels*" (CEC, 1966, p. XV).

As discussed earlier, there were three important categories of financial institutions which received deposits and granted loans in Belgium: banks, private savings institutions and public credit institutions. The distinction between these three categories was largely based on legal and historical grounds (Belgian Banking Association, 1987). However, they were also specialised in different types of business and focused very much on different clients:

- banks: traditionally concentrated on industry and commerce. Their deposits and loans were mostly short-term;
- savings institutions: focused on the market of small savers. Historically, their target group was private individuals and their main product was a savings-book account. They invested their funds mainly in mortgage loans and government securities;
- public credit institutions: they were created to perform specific missions and to fill certain 'gaps' left by the market.

5.2 Changes in the financial landscape

In the post-war period, the role of market forces in the Belgian financial system gradually increased. It went hand in hand with a growing despecialisation and internationalisation of the Belgian banking system[7]. In this essay, we will focus mostly on despecialisation, as it went together with an extension of the supervisory responsibilities of the Banking Commission, which was first transformed into the Banking and Finance Commission and later into the Banking, Finance and Insurance Commission. However, there was also a strong internationalisation of the Belgian banking sector, culminating, at the turn of the millennium, in several mergers of Belgian and foreign banks. Moreover, prudential rules came to be determined more and more by European Union directives.

The movement away from specialisation started during the 1950s and gathered momentum in the following decades. Banks, which were less bound by legal restrictions, took the lead. They expanded their activities into new market segments (Cassiers et al., 1997). This was clearly reflected in the growth of the banks' market share in areas which had traditionally been the specialisation of public credit institutions and savings banks, like savings accounts and certificates. They also diversified their assets, branching out into loans to private customers, like mortgage credit. On the whole, their market share increased.

7 For an analysis of the changes in the Belgian banking sector, see Abraham, 1990.

Table 3 - Market shares of the different groups of financial institutions in some important market segments (in %)

	End of year	Banks	Savings institutions	Public credit institutions	Total
Sight deposits	1950	87.1	-	12.9	100.0
	1960	86.2	-	13.8	100.0
	1970	77.6	1.7	20.7	100.0
	1980	66.8	4.8	28.4	100.0
	1982	70.0	5.3	24.7	100.0
Time deposits	1950	57.0	10.8	32.2	100.0
	1960	63.1	18.1	18.8	100.0
	1970	60.7	13.7	25.6	100.0
	1980	67.7	10.6	21.7	100.0
	1982	71.5	11.7	16.8	100.0
Savings accounts	1950	13.4	9.7	76.9	100.0
	1960	12.4	15.8	71.8	100.0
	1970	26.7	21.1	52.2	100.0
	1980	34.2	23.6	42.2	100.0
	1982	34.1	23.9	42.0	100.0
Bonds and certificates	1950	0.8	2.2	97.0	100.0
	1960	7.7	4.9	87.4	100.0
	1970	7.3	11.2	81.5	100.0
	1980	15.7	13.7	70.6	100.0
	1982	17.7	14.4	67.9	100.0
Credit	1958	32.5	9.8	57.7	100.0
	1970	37.8	11.8	50.4	100.0
	1980	44.4	13.4	42.1	100.0
	1990	51.0	13.5	35.5	100.0

Source: National Bank of Belgium and Belgian Banking Association.

The savings institutions also jumped on the bandwagon of the despecialisation process and expanded their market share. This was made possible by the gradual relaxation of the restrictions imposed on them. A milestone was the "Mammoth" Law of 30 June 1975, based on preparatory work of a study group, presided by the Vice-Governor of the NBB, De Voghel. As indicated by Willy De Clercq (1975), the then Finance Minister, the first objective of this law was *"Permettre une évolution ordonnée et cohérente de la déspécialisation des intermédiaires financiers"*. The law provided for an almost total despecialisation of savings institutions. Also, since 1985, they have become entitled to call themselves 'saving banks'.

The public credit institutions took part in the despecialisation process, too. Most of them were able to diversify their activities while remaining within the limits of the existing legal framework. The most significant change was the transformation of the savings division of ASLK-CGER into a full-service public 'bank' in 1980. However, public credit institutions mostly lost market share.

From the 1970s onwards, there was a sharp acceleration in the trend towards globalisation of the financial markets. Also, financial innovations started flourishing, especially on the international financial scene, with many of the new products not appearing on the balance sheet of a bank. In particular, there was a breakthrough of derivative products, like currency and interest rate swaps, currency and interest rate options and forward rate agreements.

Furthermore, attitudes towards risk capital were changing. There was a growing feeling that the aversion of savers towards shares was contributing to a weak financial structure of firms, making them much more vulnerable. In France, the July 1978 'Monory law' (named after Finance Minister René Monory) brought in tax incentives for French households acquiring shares, as well as for certain firms when issuing new shares. In Belgium, the so-called Cooreman-De Clerck law introduced similar measures in 1982.

So, in the 1970s, and especially in the 1980s, financial markets gained in importance in most countries. Three elements were important: (1) existing markets expanded and deepened significantly. The government often played a key role, with market reforms and tax incentives, as was the case in Belgium (Lefebvre, 1993); (2)

new financial markets emerged; and (3) secondary markets sprang up for many instruments.

Stronger competition in the financial sector, which also put pressure on profit margins, further stimulated the despecialisation process. Banks and non-banks were also entering into ancillary services, such as insurance, pension funds, stockbroking and financial advisory services. The trend towards diversification in retail financial services was most apparent in the efforts to provide a 'financial supermarket' with a one-stop-shop service for all financial needs. The law of December 1990, which reformed the stock market, further strengthened this process. Stockbrokers were now obliged to set up as stock exchange companies (with stricter rules concerning own funds), while credit and insurance institutions were allowed to acquire stakes in this type of company (Maystadt, 1990).

In the post-war period, there was a gradual relaxation of the shareholding restrictions on banks. The law of 3 May 1967 authorised banks to hold bonds of industrial and commercial companies as well as to hold shares temporarily in order to place them in the market. Moreover, this tendency was evident at European level (Maes, 2007). The Second Banking Directive, which came into force on 1 January 1993, partly inspired by the German model of universal banking. It allowed the acquisition by banks of insurance and investment firms as well as the creation of financial conglomerates.

In the 1990s, "bancassurance" became very trendy in Belgium. There were several acquisitions between banking and insurance companies, leading to the formation of bancassurance groups. Through these operations, concentration in the financial sector increased significantly. Noteworthy is also the participation of foreign groups (especially Dutch and French) in several of these mergers and acquisitions. Naturally, deregulation was an important factor in the growth of financial conglomerates. It was not until 1993 that credit institutions were allowed to hold stakes in insurance firms. This paved the way for big bancassurance groups to sell insurance and banking products through the same channel. Stiff competition in the sector, which exerted a downward pressure on bank profits, was another key factor. Banks responded by engaging in financial innovations and by developing new lines of business.

Furthermore, from the mid-1990s, the public credit institutions' privatisation process was put in motion. This was based on the law of 22 March 1993, under which public credit institutions became subject to the same legal and regulatory framework as other credit institutions. In the following years, most of the public credit institutions were sold to private financial groups.

5.3 An extension of the role of the Banking Commission

In line with the despecialisation of financial institutions, the responsibilities of the Banking Commission were extended over time[8]. Until April 1976, private savings institutions were supervised by the "Office Central de la Petite Épargne". In that year, the Office was wound up and its tasks transferred to the Banking Commission, in line with the recommendations of the De Voghel report (Commission Gouvernementale, 1970).

The public credit institutions had a specific supervisory status. However, in 1980, the ALSK-CGER public bank came also under the supervision of the Banking Commission. With the Law of July 17 1985, micro-economic supervision of all public credit institutions was centralised with the Minister of Finance. A government commissioner was also appointed to each public credit institution. In addition, all public credit institutions, except the ASLK-CGER, were subject to a "specialised" guardian Minister, operating alongside the Minister of Finance. A fundamental change came with the law of 22 March 1993, under which public credit institutions became subject to the same legal and regulatory framework as the other credit institutions.

Throughout the post-war period, the Banking Commission had been gradually entrusted with additional responsibilities concerning the securities markets. In 1957, it became responsible for the supervision of investment and unit trusts and, in 1964, for the supervision of all public emissions of securities. The Law of 4 December 1990 brought a fundamental reform of the way the stock market operated. The powers of the Banking Commission were extended and it was transformed into the Banking and Finance Commission.

The law of 2 August 2002 radically reorganised prudential supervision in Belgium. As part of that process, the Banking and Finance Commission and the Insurance Supervision Office were merged on 1 January 2004 to form a single supervisory body, the Banking, Finance and Insurance Commission (CBFA). Moreover, cooperation with the NBB was significantly reinforced and institutionalised.

5.4 An increasing role for the NBB at the start of the new millennium

Since the 1930s, the responsibilities of the NBB (the monetary authority and the bank of banks) were separate from those of the Banking Commission, which is responsible for traditional banking supervision, also known as micro-prudential supervision. In the last decade, the NBB has acquired an increasing role in prudential matters (Buyst, Maes and Pluym, 2005). This mainly reflects the growing importance of "macro-prudential" aspects which relate to the stability of the financial system as a whole.

The NBB has traditionally been involved in the stability of the financial system via its responsibility for payment instruments. It is in fact via the payment systems that a crisis in one institution threatens to affect other institutions, and hence the stability of the whole financial system. Also, as the bank of banks, responsible for providing liquidity to the financial system, the NBB performs a macro-prudential function. In the past few decades, the NBB has also been involved, via its international role, in developing new prudential rules at the European and wider international level.

The liberalisation and globalisation of the financial markets have made the financial system more open and more competitive. The risks within the financial system have also increased. Furthermore, the ever-accelerating pace of financial innovations makes it more difficult to assess and locate the risks. The emergence of very large financial institutions also means that a problem in one large institution could have systemic implications. All these factors are tending to blur the boundaries between macro- and micro-prudential supervision. The central bank, traditionally

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8 Over time, there were also changes in the way the Banking Commission exercised its supervision, mostly following European directives (e.g. own funds).

responsible for macro-financial stability, must not then be denied the information on the conduct of the major players who control the financial landscape, and whose failure could have a critical impact on the system. Similarly, it is vital that the institutions responsible for micro-prudential supervision should be able to tailor their action to the macro-economic context.

With the law of 17 December 1998, the NBB now has an explicit legal basis for exercising macro-prudential supervision. On 1 January 1999, it also took over the functions of the RGI. The main prudential function of the RGI was the management of the “Protection Fund for Deposits and Financial Instruments”. The Protection Fund’s task is to give financial compensation to depositors and investors who have suffered damages following the bankruptcy of a credit institution or investment undertaking. The RGI has been involved in these activities since 1975, when a "Security pool" was set up to compensate depositors of a credit institution which went bankrupt (Vandeputte, Abraham and Lempereur, 1981).

Stronger links were also established between the NBB and the BFIC, the aim being to ensure closer cooperation and to develop synergies. Thus, three members of the NBB’s Board of Directors are also members of the BFIC’s Management Committee. In addition, as foreseen in the law of August 2002, a Financial Stability Committee was established in 2003. It comprises the members of the NBB’s and BFIC’s boards, and is chaired by the governor of the NBB. It deals with all matters of common interest, such as the overall stability of the financial system, the coordination of crisis management and the management of synergies between the two institutions. A Financial Services Authority Supervisory Board was also set up in 2004, combining the BFIC supervisory board and the NBB’s Council of Regency. This Board, which once again is chaired by the governor of the NBB, has a primarily advisory role concerning the organisation and operation of the financial markets and institutions. However, the BFIC has retained its powers of micro-prudential supervision and autonomy of decision. The Law of 2 August 2002 also obliged both institutions to cooperate and to pool resources in order to realise synergies.

6. Conclusion

After severe crises in 1838 and 1848, the National Bank of Belgium was established in 1850, marking a fundamental reform of the Belgian financial system. It aimed at rendering the financial system more crisis-resistant, especially by restricting the leverage of the banking sector. The NBB was subject to strict rules and could grant only short-term credit against collateral. However, with the spread of deposit accounts, the leverage in the Belgian financial system increased again, with investments in industry being financed by short-term deposits.

The Great Depression and the bankruptcies of the 1930s brought to the fore the weaknesses of the Belgian financial system. It led to major reforms, while also enhancing the role of the government in the financial sector. A decree adopted in August 1934 required the mixed banks to be split up into two separate institutions: a pure deposit bank and a holding company. Separating deposit taking from the acquisition of shares greatly reduced the risk of liquidity problems and restricted again the leverage of the banking sector. A Decree of July 1935 established the Banking Commission. This institution had the power to require the banks to maintain a liquidity ratio and a solvency ratio. Also, via a network of independent, certified auditors the new institution coordinated the supervision of each individual bank's activities. Moreover, the government established, by Decree of June 1935, the Rediscount and Guarantee Institute (RGI), for rediscounting medium- or long-term receivables, something which the NBB was prohibited to do (and which had hampered financial rescue operations).

In the post-war period, there were no major banking crises in Belgium. So, reforms in the institutional framework of banking supervision were not driven by crises, like in the interwar period, but by changes in the financial landscape, especially an increasing role for market forces. This went hand in hand with a process of deregulation, leading also to a greater internationalisation and despecialisation of the financial system. In line with the despecialisation process, the responsibilities of the Banking Commission were gradually extended, covering savings institutions and several aspects of the financial markets, too. In 1990, it was transformed into the Banking and Finance Commission. Around the year 2000, the organisation of prudential control in Belgium underwent thorough changes. -As a result, the role of the NBB in prudential matters was widened. Since 1 January 1999, the date on which it also took over the functions of the RGI, the NBB has had an explicit legal basis for exercising macro-prudential supervision. Under the law of 2 August 2002, prudential supervision in Belgium was fundamentally reorganised. As part of that process, the Banking and Finance Commission and the Insurance Supervision Office were merged into a single supervisory body, the Banking, Finance and Insurance Commission (BFIC). Stronger institutional links were also established between the NBB and the BFIC, to ensure closer cooperation and to develop synergies. So, by the early 21st century, the supervision of the financial system had been radically overhauled.

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Annex - Main developments in the post-war period

1946 Introduction of liquidity and solvency coefficients for banks.

1957 Banking Commission becomes responsible for the supervision of investment and unit trusts.

1964 Banking Commission becomes responsible for the supervision of all public emissions of securities.

1967 Banks allowed tohold shares temporarily, in order to place them on the market.

1970 Report of the "Commission gouvernementale pour l'étude de propositions de réforme des lois relatives à la banque et à l'épargne" (Rapport De Voghel).

1975 Constitution of a "Security pool" at the RGI to compensate depositors in the event of a bankruptcy.

Law of 30 June ("Mammoth" law). The law provided a framework for the despecialisation process.

1976 Tasks of "Office Central de la Petite Épargne" transferred to the Banking Commission.

1980 Banking Commission becomes responsible for the supervision of CGER-public bank.

1985 Micro-economic supervision of all public credit institutions centralised with the Finance Minister (exception CGER-public bank).

1990 Law of 4 December, reforming the stock exchange. The Banking Commission is transformed into the Banking and Finance Commission.

1993 Coming into force of the Second Banking Directive (allowing the German model of universal banking).

Credit institutions allowed holding participations in insurance firms.

Law of 22 March. Public credit institutions become subject to the same legal and regulatory framework as other credit institutions. Start of privatisation process.

1999 NBB becomes responsible for macro-prudential supervision and takes over the prudential functions of the RGI.

2002 Law of 2 August on the supervision of the financial sector.

2003 Creation of the Financial Stability Committee

2004 Creation of Banking, Finance and Insurance Commission.

Creation of the Financial Services Authority Supervisory Board.

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