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# The Belgian Credit Guarantee Scheme[1]

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Yale Program on Financial Stability Case Study
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**Abstract**

Much like other developed economies during the global financial crisis, Belgium faced substantial systemic stress to its large and heavily concentrated financial system. To combat these mounting pressures, the Belgian government launched a wide-ranging, opt-in state debt guarantee program in a concerted effort to instill confidence and stymie the fear of runs in its financial sector. The debt guarantee scheme, pursuant to which eligible institutions could issue government-guaranteed debt, was originally put into place on October 15, 2008, and retroactively covered liabilities entered into from October 9, 2008, to October 31, 2009, with a maximum maturity of three years. It provided significant discretionary authority to the Minister of Finance, such as the ability to add additional conditions and to decline any bank from participating in the scheme. Eligibility was determined on a case by case basis. Fees and issuance thresholds were determined in the same way prior to two April 14, 2009, Royal Decrees, which homogenized fees and expanded the pool of eligible institutions. Belgium was also a key member in a number of high profile bank rescues, such as that of Dexia in conjunction with France and Luxembourg. Much of the structure of the guarantee scheme was initially based on the ad hoc scheme that the three nations devised for Dexia earlier in October 2008. The state guarantee scheme expired after no banks had made use of it by October 31, 2010, the last day for banks to issue guaranteed debt after amendments to the issuance window and maturity horizon.

**Keywords**: Belgium, short-term debt, medium-term debt, financial institutions, government guarantee, guarantee scheme

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[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering the responses to the global financial crisis that pertain to bank debt guarantee programs.

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# The Belgian Credit Guarantee Scheme

## At a Glance

As the U.S. housing crisis exploded into a global phenomenon in 2008, dozens of large European financial institutions began facing run-like behavior from their investors. Belgian banks, despite being more limited in their exposure than others, were no exception. As credit default swap (CDS) spreads of various maturities for large banks such as Dexia and Fortis spiked from less than 100 basis points in May of 2008 to nearly 500 basis points in September, Belgian authorities stepped in. The Minister of Finance announced a state guarantee scheme on October 15, 2008, which drew heavily from a Belgian, French, and Luxembourg guarantee for Dexia that was finalized on October 14, 2008.

| Summary of Key Terms | |
|---|---|
| Purpose: To restore confidence and liquidity to Belgian financial institutions through the guaranteeing of short and medium-term liabilities for systemically important institutions. | |
| Announcement Date | October 15, 2008 |
| Operational Date | October 15, 2008 |
| Date of First Guaranteed Loan issuance | N/A |
| Issuance Window Expiration Date | October 31, 2009 (initial); extended to October 31, 2010. |
| Program Size | Unspecified |
| Usage | None |
| Outcomes | N/A |

The state guarantee scheme entered into force retroactively, covering liabilities issued from October 9, 2008, to October 31, 2009, with a final maturity date of October 31, 2011, for a maximum maturity of just over three years. Eligible liabilities were quite broad, encompassing bonds, debt securities, interbank, fiduciary, and central bank and institutional deposits, as well as commercial paper, certificates of deposit, and medium-term notes. Initially, the fee structures were unspecified. After requests from the European Central Bank for more clarity in consultation reports, as well as continued macroeconomic stresses across the region, the Belgian government issued the Royal Decree of 14 April 2009, which specified a 70 basis point set-up fee for the principal amount to be guaranteed, as well as a 100 basis point fee, paid quarterly, for the amount covered.

The Belgian government did not opt to put an explicit ceiling on the guarantee. However, it did require banks to take measures that would "support their financial situation," and insisted that the guarantee be "justified in the interests of the Belgian economy and by the protection of all depositors." Additionally, the Minister of Finance was at any time able to impose additional conditions and reject any institution.

The program's issuance window was extended once in September 2009, to October 31, 2010. No banks applied for or utilized the guarantee scheme.

## Summary Evaluation

International Monetary Fund evaluation of Belgium's crisis response measures made several recommendations but didn't have much to say on the effectiveness (or potentially lack thereof) of the debt guarantee program.

| The Belgian Credit Guarantee Scheme: Belgium Context | |
|---|---|
| **GDP (SAAR, Nominal GDP in LCU converted to USD)** | $471.1 billion in 2007<br>$517.8 billion in 2008<br>*Source: Bloomberg* |
| **GDP per capita (SAAR, Nominal GDP in LCU converted to USD)** | $44,263.0 in 2007<br>$48,107.0 in 2008<br>*Source: Bloomberg* |
| **Sovereign credit rating (5-year senior debt)** | As of Q4, 2007:<br>Fitch: AA+<br>Moody's: Aa1<br>S&P: AA+<br><br>As of Q4, 2008:<br>Fitch: AA+<br>Moody's: Aa1<br>S&P: AA+<br>*Source: Bloomberg* |
| **Size of banking system** | $411.1 billion in total assets in 2007<br>$441.2 billion in total assets in 2008<br>*Source: Bloomberg* |
| **Size of banking system as a percentage of GDP** | 87.3% in 2007<br>85.2% in 2008<br>*Source: Bloomberg* |

| | |
|---|---|
| **Size of banking system as a percentage of financial system** | Data not available for Belgium<br><br>*Source: World Bank Global Financial Development Database* |
| **5-bank concentration of banking system** | 96.4% of total banking assets in 2007<br><br>95.4% of total banking assets in 2008<br><br>*Source: World Bank Global Financial Development Database* |
| **Foreign involvement in banking system** | 13% of total banking assets in 2007<br><br>14% of total banking assets in 2008<br><br>*Source: World Bank Global Financial Development Database* |
| **Government ownership of banking system** | 1% of banks owned by the state in 2005<br><br>*Source: World Bank BRSS* |
| **Existence of deposit insurance** | Data not available for relevant time frame in Belgium<br><br>*Source: World bank Deposit Insurance Dataset* |

# I. Overview

## Background

Following the failure of Lehman Brothers in September 2008, global financial markets were shaken significantly. This market pressure manifested itself as a global drying-up of liquidity and short and medium-term wholesale funding. The EURIBOR-OIS spread, which serves the same purpose as the oft-cited LIBOR-OIS spread as a proxy for overall market credit risk in European banks, rose from less than 10 basis points (bps) to almost 100 bps for all maturities, and nearly 165 bps for longer-term maturities in the third quarter of 2008.

Belgian banks were no different, experiencing sharp declines in share prices and steep price increases for access to wholesale financing. Several of the largest banks, including Fortis and Dexia, saw premiums on their credit default swaps (CDS) of various maturities shoot up by several hundred basis points, peaking out at around 500 bps for the two (2009 Financial Stability Overview). In particular, four of the largest Belgian institutions—Dexia, Ethias, Fortis, and KBC—faced potential liquidity shortages as institutional depositors and other sources of wholesale funding continued to pull away.

This lack of liquidity prompted the Belgian government to push an unprecedented amount of State aid into its financial sector. Aid ranged from increasing the deposit insurance ceiling from €20,000 to €100,000; to substantial targeted capital injections for a small group of systemically important financial institutions totaling tens of billions of euros; to broad-based State guarantee schemes to cover assets and liabilities entered into by Belgian financial institutions. This case study focuses specifically on the government's program to guarantee liabilities.

## Program Description

The original credit guarantee, based on the Law of October 15, 2008, in the Belgian Official Gazette, aimed to restore confidence in the financial sector and promote access to funding sources that had been closed off by the global credit crunch. The Law of October 15, 2008, introduced Article 117*bis* in the Law of 2 August 2002 (later abrogated by Article 23 of the Law of July 2, 2010).[3] Article 117*bis* gave the Belgian government the ability to enact policies that could deviate from implemented financial statutes based on exigent circumstances and the condition of its financial system. It provided Belgian authorities a substantial amount of legal flexibility in a time of crisis and specifically vested the Belgian government[4] with the power to adopt a "system of guarantees of commitments entered into by supervised institutions" (Article 117*bis,* Belgian National Gazette, 2008-10-15). Solvency and liquidity concerns, particularly with larger banks like Dexia, Fortis, and others, had been mounting, and

[3] Article 117 itself specified that the National Bank of Belgium (NBB), the Banking, Finance, and Insurance Commission (CBFA), and the Office of Insurance Control (OCA) work together and collaborate on matters of common interest, which included (1) "the stability of the financial system as a whole"; (2) "the interactions between prudential supervision and control of systemic risks of payment and settlement systems"; (3) "coordination of crisis management"; and (4) "the guarantee of deposits and the protection of investors", among others (Article 117, Belgian National Gazette, 2002-09-04).

[4] The king acting by Royal Decree, i.e. a mandatory legal act of general application adopted by the executive branch.

the adoption of Article 117*bis* by the Law of October 15, 2008, pursuant to which eligible institutions could issue government-guaranteed debt, allowed Belgian authorities to implement any programs necessary to alleviate these substantial pressures. The government implemented Article 117*bis* and adopted the Royal Decree of December 10, 2008, on the guarantee of certain risks assumed by financial institutions.

The types of eligible liabilities were extensive, and included, "all of the financing raised by a beneficiary institution in order to obtain refinancing from credit institutions and institutional counterparties and would cover instruments such as bonds and debt securities issued by the beneficiary to institutional investors, as well as interbank deposits, fiduciary deposits, deposits of central banks, deposits of institutions, commercial paper, certificates of deposit and medium-term notes." There was some objection to the breadth of the eligibility criteria by the European Central Bank (ECB), specifically with respect to the decision to include interbank deposits. No specific liabilities were excluded (European Central Bank 2008b).

Participating financial institutions were required to meet the following conditions: (1) beneficiaries would take measures aimed at supporting their financial situation, solvency, and liquidity, and (2) the granting of a guarantee would be justified in the interests of the Belgian economy and by the protection of all depositors. The ECB raised objections to these conditions as well, citing the Law of 2 August 2002's requirement of a "sudden crisis on the financial markets or of a serious threat of systemic crisis" and arguing that Belgium's conditions did not reflect this requirement. These conditions were not amended in the final version of Article 117*bis*.

To have their debt guaranteed by the government, institutions also had to prove that (1) they were unable to issue new liabilities to cover maturing liabilities absent the guarantee and (ii) the guarantee was be "necessary to ensure their continuity." Additionally, the Minister of Finance was allowed to lay down further conditions for the guarantee, including "setting its ceiling, specifying the remuneration to be paid for the granting of the guarantee, and any other modality aimed at ensuring compliance with the two abovementioned conditions" (European Central Bank 2008b).

The Belgian approach was an "opt-in" one, so banks had to apply to gain access to the guarantee. The fee structure was originally unspecified, suggesting that a per-bank analysis would be used to assess the exact fee amounts (European Central Bank 2008c) The policy could be applied retroactively, covering bonds that had been issued or renewed from October 9, 2008, until October 31, 2009, with maturity dates of no later than October 31, 2011. Therefore, guaranteed obligations could have maturities of slightly more than three years at most.

While the fee structures were unspecified in the original agreement (European Central Bank 2008c), another Royal Decree, issued on April 14, 2009, clarified and homogenized the fees. The amendment provided that the guarantee fee consisted of: (1) a set-up fee of 70 basis points (bps) of the principal amount covered by the guarantee, and (2) an annual guarantee fee of 100 bps of the principal amounts covered by the guarantee, paid quarterly.

**Outcomes**

The guarantee scheme was renewed on October 7, 2009, by Belgian authorities despite a lack of usage. This extension was made primarily because it was seen as "necessary given the

continuation of financial market turbulence, and in particular financial institutions' continued refinancing difficulties." Belgian authorities extended the final maturity date of the State guarantee from October 31, 2011, to October 31, 2014. Additionally, the window during which guaranteed liabilities could be issued was extended from October 31, 2009, to October 31, 2010. Last, the maximum maturity window was also increased to match the new conditions. On October 14, 2009, the Belgian, French, and Luxembourg authorities would, on October 14, 2009, amended the issuance window and maturity horizon in the Dexia agreement in the same way.

Despite the extension, no banks applied for the guarantee scheme. The scheme therefore expired on October 31, 2010.

# II. Key Design Decisions

## 1. The State guarantee scheme was a part of a package of State policy measures passed in October 2008 to instill confidence in the Belgian banking system.

In addition to the debt guarantee scheme, the Belgian government also increased its limit of deposit insurance covered by the Protection Fund from €20,000 to €100,000. They also incorporated a broad-based asset protection scheme from the Royal Decree of December 10, 2008, that covered, "directly or indirectly, losses or risks of losses on financial assets held by subsidiaries, whether direct or indirect, of the guaranteed entity,," and capital injections for certain large institutional rescues as well. The Belgian government also engaged in a number of ad hoc rescues, the most notable of which being that of Dexia. The Dexia agreement, finalized on October 14, 2009, served as the model for the State guarantee scheme.

## 2. The 2008 guarantee scheme drew its authority from Article 117*bis*, an amendment to the Law of August 2, 2002, by the Law of October 15, 2008.

Article 117*bis*, introduced by the Law of October 15, 2008, added to the statutory authority of Article 117 of the Law of August 2, 2002, which specifically outlined financial stability and crisis management, among other things, as matters of common interest between the National Bank of Belgium (NBB) and the Banking, Finance, and Insurance Commission (CBFA). Article 117*bis* allowed the Belgian government to "provide for supplements to, or deviations from, the Belgian Credit Institutions Supervision Law, the Insurance Undertakings Supervision Law, the Investment Services Law, and the Financial Sector and Financial Services Supervision Law" under exigent circumstances. It also provided for "a system of State guarantees for credit institutions, insurance undertakings and other financial institutions (as will be further determined by Royal Decree)".

## 3. The guarantee scheme was subject to European Commission approval.

As a form of state aid, the guarantee scheme was subject to review and approval by the European Commission.

## 4. There was no explicit maximum amount that the Belgian government would guarantee.

Belgian authorities' approach was to evaluate any bank that came forward on a case-by-case basis. While no guaranteed debt was issued, a total size was never specified for the program.

5. **Most Belgian financial institutions were eligible.**

All credit institutions, financial holding companies, investment firms, as well as any financial institution under prudential supervision were eligible to participate (Petrovic and Tutsch 2009).

6. **The types of eligible debt were very broad, and included liabilities of supervised institutions, commercial paper, and interbank deposits, among others.**

Specifically, the Belgian government publicly announced that liabilities covered included "all of the financing raised by a beneficiary institution in order to obtain refinancing from credit institutions and institutional counterparties and would cover instruments such as bonds and debt securities issued by the beneficiary to institutional investors, as well as interbank deposits, fiduciary deposits, deposits of central banks, deposits of institutions, commercial paper, certificates of deposits and medium-term notes" (European Central Bank 2008b).

However, the ECB indicated in its initial consultations on the law that it believed the criteria for eligible debt was too broad, particularly with the inclusion of interbank deposits. Their concerns primarily addressed the possibility that such broad-based eligibility criteria would harm euro-area efforts to harmonize monetary policy responses. The Belgian government did not address these criticisms and kept interbank deposits among the covered liabilities (European Central Bank 2008b).

7. **The maximum maturity for guaranteed debt under the original agreement was slightly more than three years, with an ultimate maturity date of October 31, 2011. The maximum maturity and ultimate date were both extended in 2009.**

Debt that would have been issued under the October 2008 guarantee had an ultimate maturity date of up to October 31, 2011. Therefore, the maximum maturity for any guaranteed debt would have been slightly more than three years. However, the issuance window and maturity horizon were extended on October 7, 2009, to October 31, 2011, and for liabilities maturing up to October 31, 2014, respectively, providing for a maximum potential maturity of slightly more than five years.

8. **All currencies appear to have been eligible for the scheme.**

Program documents did not contain any restrictions on the currencies eligible for participation in the scheme.

9. **There were no explicit individual caps.**

There is no indication that there were individual ceilings on the amount of guaranteed debt that a given institution could issue.

10. **Fee structures were implied to be case by case at the start of the agreement, but were later clarified by the Royal Decree dated April 14, 2009, as on a flat-fee basis.**

The State guarantee fee structures were originally to be determined on a case-by-case basis (European Central Bank 2008c), but were further specified by the Royal Decree of April 14, 2009. The fees included a set-up fee of 70 bps of the principal amount the guarantee covered and an annual guarantee fee of 100 bps of the principal amounts covered by the guarantee, paid quarterly.

**11. Banks had to take broad-based measures to improve their financial situation and prove there was sufficient need for a guarantee.**

Participation conditions for beneficiaries mandated that institutions "take measures aimed at supporting their financial situation, solvency, and liquidity," and that, should a guarantee be granted, it would be in the interests of the Belgian economy and by the protection of all depositors.

After being approved, beneficiaries were able to issue government-guaranteed debt only if they were able to show that it would not be possible for them to meet the liabilities that would be covered by said guarantee at their maturity without it and that the invoking of said State guarantee was necessary for the beneficiary's continuity (European Central Bank 2008b).

**12. There were no additional conditions imposed for the State guarantee scheme. However, the Minister of Finance was entitled to impose more if he or she saw fit.**

The Finance Minister had substantial discretionary authority to "lay down further modalities and conditions for a State guarantee, including setting its ceiling, specifying the remuneration to be paid for the granting of the guarantee, and any other modality aimed at ensuring compliance with the two abovementioned conditions" (European Central Bank 2008b) The Minister of Finance also had the authority to terminate any guarantee agreement at any time.

**13. The issuance window for the program originally ended at the end of October 2009, but it was extended for another year.**

The original State guarantee was implemented October 17, 2008, retroactive from October 9, 2008, and extending to October 31, 2009, with an ultimate maturity date of October 31, 2011. It was later further extended on October 7, 2009, which lengthened the issuance window to October 31, 2010, and the ultimate maturity date to October 31, 2014.

## III. Evaluation

There does not appear to be any specific formal analysis for the Belgian credit guarantee scheme. However, in 2013, the IMF released a comprehensive analysis of how the Belgian government responded to the global financial crisis (GFC), including best practice guidelines. Some of the recommendations that the Fund made included (1) enhancing the National Bank of Belgium's resolution authority by broadly formalizing and making explicit many of its powers; (2) requiring recovery and resolution plans for any systemically important Belgian firm; (3) formalizing frameworks for bank resolution and/or insolvency, with consideration given to further broaden these for holding companies and non-systemic institutions; and (4)

ensuring strict conditionality on any agreements or guarantees made (International Monetary Fund 2013).

It is worth noting that, while the IMF made several sweeping recommendations in their report, they had very little to say on the effectiveness (or potential lack thereof) of the debt guarantee program. The only specific recommendation they had with respect to guarantees was that the National Bank of Belgium should "henceforth exercise restraint in granting new guarantees to avoid a further migration of potential private losses to the sovereign balance sheet" (International Monetary Fund 2013).

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# V. Key Program Documents

### Summary of Program

Law introducing measures to promote financial stability and establishing, in particular, a State guarantee for credits granted and other operations carried out in the context of financial stability (10/15/2008) – *Law establishing a state guarantee for credits granted and general operations for responding to the GFC.* https://ypfsresourcelibrary.blob.core.windows.net/fcic/YPFS/Moniteur%20Belge%20-%20Belgisch%20Staatsblad.pdf.

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**Legal/Regulatory Guidance**

Law of August 2, 2002 on the supervision of the financial sector and on financial services (09/04/2002) – L*aw establishing the oversight and regulation of the financial sector.* https://ypfsresourcelibrary.blob.core.windows.net/fcic/YPFS/Moniteur%20Belge%20-%20Belgisch%20Staatsblad11.pdf.

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