Introduction

Prior to the spread of the financial crisis, Belgium enjoyed the enviable position of having never suffered from a systemic financial crisis. Its banks enjoyed a high degree of capitalization and stability. Despite such favorable initial conditions, Belgium’s financial system soon found itself caught in the maelstrom, with the government forced to intervene extensively in order to avoid the crisis from worsening. The country’s position changed from one of home country to large bancassurance firms to that of a host country in the wake of the crisis.

The Belgian experience casts light on the Varieties of Financial Capitalism (VOFC) literature in that it illustrates the extent to which pre-existing financial structures contributed to its vulnerability to contagion and the government’s handling of the crisis. Although the structure of Belgium’s financial system classifies it as a “coordinated market economy” and its financial system bank-based (Hall and Soskice 2001; Schmidt 2002; Allen and Gale 2000), such classifications have become less useful in recent years (Hardie and Howarth 2010). This article argues that the high level of financialization that took place in Belgium over the last two decades made Belgium’s profile look less and less like that of a coordinated market economy and opened it up to unexpected vulnerabilities during the crisis despite the continuation of some of the key elements of coordinated market economies. The article begins with an overview of the characteristics of the Belgian financial system and financial regulatory system in place on the even of the financial crisis. The next section covers the contagion to Belgium after the fall of Lehman Brothers in September 2008 and the steps taken by the Belgian government to restore stability. The following section considers the aftermath of the crisis and how it changed both the basic characteristics of the financial sector as well as the institutions governing it. The concluding portions consider this in light of the varieties of financial capitalism literature and how Belgium’s high degree of “financialization” affected its capacity to manage the crisis.

The Belgian Financial System

The varieties of capitalism literature posits that a coordinated market economy will feature a bank-based system offering “patient” capital in a financial system that is relatively concentrated among a few major players. Such systems pursue retail banking more so than wholesale, thus leading to more conservative investment patterns overall.
The Belgian financial system historically has been characterized by the domination of a few large banks and a relatively weak regulatory structure. In the 1990s, however, Belgium underwent a major financial transformation that retained some core characteristics (highly concentrated bank-based system) but also made the system more financialized in nature, opening markets to foreign access as well as heavily leveraged institutions.

In the 1830s two universal banks (Société Genérale and the Banque de Belgique) were the major financial institutions. When the National Bank of Belgium (NBB) was founded in 1850, it was not made the official lender of the last resort; instead it shared this role with the Finance Ministry, and the extent to which it undertook this responsibility depended on the decisions of the latter. In fact, when universal or investment banks underwent difficulty the Finance Minister could bypass the NBB altogether and instead go to the largest universal bank (Société Générale) to perform rescue operations (Maes 2009).

One researcher characterized the Belgian financial situation in the early 20th century as, “a very liberal country with no specific legal controls over financial institutions” (Maes 2009), lacking even standardized accounting practices. The 1930s brought numerous reforms in Belgium that were based on the British system of specialization, separating deposit banks from holding companies. Moreover a Banking Commission was established in 1935 to regulate the degree of leveraging financial institutions could undertake by demanding specific liquidity/solvency ratios. These reforms were short-lived: two decades later, banks expanded both their activities (with the development of savings accounts and certificates) and their assets (delving into mortgages).

Financial consolidation continued with a “big bang” taking place in Belgium following the oil shocks of the 1970s. Both European-level policies and national-level policies encouraged this development. In 1979 the Belgian franc joined the European Monetary System, which effectively fixed its exchange rate to the West German mark, thereby lowering its risk premia and promoting the integration of Belgian financial markets with European and international networks. The Single European Act that was signed in the mid-1980s and created plans to consolidate the European Community’s internal market further contributed to European (and by implication Belgian) financial integration. In particular, the SEA called for the removal of capital controls, which undermined the financial repression undertaken by several European countries (including Belgium) in order to channel capital towards financing government debt. Domestically, the Belgian government undertook important reforms, including opening the public debt market to foreign firms, undoing the separation of deposit and portfolio investments in 1993, and eliminating the oligopolistic establishment of deposit rates (Wyplosz 1999). Credit institutions became major stakeholders in insurance firms, ending the cartelization of Belgian finance and leading to the bancassurance groups that combined banking and insurance and led to the further concentration of financial markets, as indicated by Figure 1 (Buyst and Maes 2009).
Four bancassurance groups dominate the Belgian financial system today (see Figures 2 and 3). Prior to the onset of the global financial crisis, Fortis (now a subsidiary of BNP Paribas), Dexia, KBC, and ING Belgium (a subsidiary of the Dutch bank, ING) controlled 80% of the Belgian financial market (deposits, assets, loans).

Banking comprised the major part of the financial sector with assets exceeding 1.3 trillion euros in 2005, over 440 percent of GDP. The insurance sector’s assets amounted to just under 60 percent of GDP—see Table 1 (IMF 2006). Fortis alone possessed assets several times that of Belgium’s GDP at 445b euros in assets (The Times (London), 29 September 2008) and had the distinction of being Belgium’s single largest employer (The Daily Telegraph, 12 February 2009). The high level of banking concentration in Belgium is similar to that found in Finland and the Netherlands, though other small countries operate banking systems that are far less concentrated (such as Austria, Denmark, Ireland and Greece).¹

On the one hand, the bancassurance model offers consumers a wide range of financial products in a system where risk is diversified. On the other hand, the complexity of this model makes regulation difficult as they tend to be less transparent and there exists the possibility of regulatory arbitrage between the banking versus insurance sections (IMF 2006: 11).

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Figure 2 Bancassurance conglomerates’ market share in Belgian banking, 2004 in percentage

Figure 3 Bancassurance conglomerates’ market share in Belgian insurance, 2004 in percentage

Table 1 Composition of Belgian financial sector, 2004

<p>| Banks | 75.2 |</p>
<table>
<thead>
<tr>
<th>Insurance companies</th>
<th>10.8</th>
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<tbody>
<tr>
<td>Others</td>
<td>14</td>
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</table>

Source: IMF 2006

By European standards, Belgium’s banking sector is quite significant, amounting to over 600 percent of Belgian GDP, with the EU average close to 500 percent and the Eurozone 477 percent (IMF 2010). These financial institutions were significantly leveraged: in 2007 they received 510b euros in deposits, with outstanding loans totaling 630b euros (High Level Committee 2009). The heaviest exposure of the Belgian financial sector is to France, the US, the UK, and the Netherlands (IMF 2010: 13). This made Belgian banks more leveraged than others in the EU-13, though their capitalization and liquidity exceed that of the EU and Euro area (IMF 2006: 13-4).

By 2005, household lending (including mortgages) had overtaken lending to the corporate sector, which increasingly looked to capital markets for financing. Moreover, corporate borrowing from Central and Eastern European countries rose (IMF 2005). The three major Belgian banks invested heavily in the CEE countries, plus Turkey: Fortis had subsidiaries in Poland and Turkey, KBC maintained links in the Czech Republic, Slovakia, Hungary, Poland and Russia, while Dexia had a Turkish subsidiary (NBB 2010: 52). Indeed, “with deleveraging by enterprises, mortgage lending and expansion abroad became the key drivers of bank activity” (IMF 2005). As a whole, bank credit played a more important part in the growth of the Belgian financial sector than domestic financial market activities, like equities or bonds.²

Belgian Financial Regulation

Belgium had an integrated model (set to change in 2011) in which the NBB was legally charged with macro-prudential supervision in 1998 and another institution handling the micro-level. In 2004 the Banking and Finance Commission (created in 1935) merged with the Insurance Supervision Office (created in 1975) to form the Banking, Finance and Insurance Commission (CBFA—Commission Bancaire, Financière et des Assurances) to keep up with the rise of the bancassurance groups. This institution was charged with the “prudential supervision of financial institutions, supervision of information and of the operation of financial markets, and the supervision of the status of other professionals in the financial sector (brokers, agents and sub-agents)” (CBFA website). CBFA supervision extended to banks and other credit institutions, insurance companies, investment firms (including stockbroking) and companies that manage retirement funds. The IMF has judged the CBFA to have “appropriate autonomy and powers for banking supervision…[though] it could be helpful to establish a clear, broader mandate for the CBFA to reflect its responsibility to contribute to financial stability and protect consumers through its oversight of banking, capital markets activity, and insurance” (IMF 2006, p34).

Two committees were created in order to encourage dialogue between the NBB and the CBFA. The Financial Stability Committee was formed in 2003, drawing on members of the boards of both the NBB and CBFA. Its responsibilities included the stability of the financial system, coordinating crisis management and overseeing the synergies between institutions. Another committee, the Financial Services Authority Supervisory Board, was created in 2004 to provide counsel on the organization and operation of financial markets and institutions. This committee provides advice on the organization and operation of the financial markets and financial institutions and is composed of the CBFA’s Supervisory Board and the NBB’s Council of Regency (CBFA) (Buyst and Mayes 2009).

Following recommendations from the 2005, Financial Services Action Plan (FSAP), the Belgian financial system’s supervisory framework continued to be modified. The CBFA was streamlined, regular stress tests were performed, and work was done to continually improve relations between the CBFA and the NBB (IMF 2010). Despite these suggestions, the FSAP report was largely complimentary towards the Belgian financial system, citing the traditionally conservative attitude towards risk by the banking sector, the large reserve of government securities, a stable macroeconomic policy framework and the adherence to a high level of banking supervision standards that complied with international standards. Moreover, the bancassurance model was seen as being a positive factor for its diversifying nature. Indeed, Belgium had never suffered from a systemic financial crisis, and these “Belgium-specific features” were credited (IMF 2006).

Nevertheless, the openness of Belgian banks still made them susceptible to financial contagion. (FSAP assessment, IMF Country Report No. 06/75). The OECD had noted the lack of transparency inherent in the bancassurance firms that would typically employ “cross-selling strategies, which as such raise switching costs and reduce price transparency, leading to lower competitive pressures.” The same report stated an “extensive” degree of government intervention in consumer credit and mortgage loan markets, thereby dampening innovation and competitiveness. Furthermore tax incentives that favor certain types of savings (like household savings accounts, pensions, life insurance and mortgages) unduly impacted savings allocation without a corresponding benefit to consumers.3

**Government Response to the Global Financial Crisis**

As recently as February 2006, the IMF declared that the Belgian “financial system is generally sound, resilient to potential adverse shocks, and well supervised. Risks both on the international level and domestically appear well within the banks’ capacity to manage them and are well understood by the supervisor and overseer of the system” and that “near-term vulnerability appears low” (IMF 2006, p 1, 6).

The initial wave of countries hit by the financial crisis in the wake of the American subprime crisis affected countries with pre-existing weaknesses. The first countries to

3 http://www.oecd.org/document/38/0,3343,en_2649_34593_38208614_1_1_1_1,00.html
undergo a recession in the first quarter of 2008 were the US, Ireland, Iceland, Latvia and Estonia. These countries possessed financial sectors that were particularly vulnerable given their high exposure to the American financial sector. The next group of countries affected by the crisis was those with domestic vulnerabilities, those who had undergone a housing boom, rapid credit growth, and were directly exposed to American economy. These countries included France, Germany, Italy, the Netherlands, and the UK. Belgium was not affected until the fourth quarter of 2008, after many of the other Eurozone economies (Stijn et al 2009).

Belgium originally seemed to be in a good position to weather the financial crisis. Its exposure to subprime mortgages was low, and its exposure to asset-backed securities and collateralized debt obligations was deemed “moderate” (IMF 2008). Credit risk stress tests for exposure to subprime mortgages also indicated the Belgium should come out of the crisis unscathed. Moreover, Belgian banks have traditionally been well capitalized, and Belgium enjoys a high personal savings rate and low household leverage, both of which were stabilizing factors (IMF 2008). Belgium had long enjoyed a high rate of household saving, a factor attributed to “historically high government debt, precautionary savings for old age, and various fiscal incentives” (IMF 2006, p20).

Indeed, Belgian banking was booming: according to a study by McKinsey, Belgium’s private banking market grew by 27 percent a year from 2004-2005, more than double the European average (The Economist, 6 January 2007). Moreover, an increasing amount of growth stemmed from foreign markets. Between 199 and mid-2005, total foreign exposure almost doubled, surpassing 850b euros, with the major bancassurance groups making up 95 percent of the exposure. The bulk is in western Europe and the US (together comprising 80 percent), though the central and eastern European countries (in particular the Czech Republic, Hungary and Poland) had grown quickly and made up 5 percent of total foreign exposure (IMF 2006, p16).

After the crisis reached Belgium, the government needed to heavily intervene in financial markets through recapitalization, the provision of guarantees, government loans, and augmenting protection for depositors. Emergency liquidity assistance remains a national responsibility under the Eurosystem, and the NBB has established principals according to which emergency liquidity is given: 1.) only as a last resort; 2.) should be fully collateralized; 3.) should only be used for liquidity issues, not solvency (IMF 266, p26).

Following the Lehman Brothers failure in September 2008, the price of credit default swaps (CDS) for Fortis and Dexia exceeded an annual premium of 500 basis points, significantly above the premium of a benchmark of European financial institutions. KBC’s CDS premium also ran over this benchmark, though it was less extreme (NBB 2009 p29).

The first recapitalization involved the Fortis Group on 29 September 2008, having lost over a third of its market value during the week prior to the rescue (The Guardian (London), 29 September 2008). Its problems began with its acquisition of the Dutch operations of ABN-Amro in October 2007 (in which Fortis was involved in a consortium
with the Royal Bank of Scotland and Santander of Spain in a deal estimated at €70b, the biggest banking takeover in history). The €24b wiped out Fortis’s capital, and it was unable to get additional liquidity given the near-frozen state of capital markets. Moreover confusing statements regarding its involvement in the subprime market contributed to a loss of investor confidence (IMF 2009: 11). The government assured depositors a “100 percent” guarantee, despite the legal limit of €20,000 under Belgian law. The respective governments of Belgium, Luxembourg and the Netherlands invested billions of euros in exchange for equity. The Belgian government’s €4.7bn got it a 49 percent share in the common equity of Fortis Bank NV/SA. The Netherlands paid €4 euros in exchange for 49 percent share in the common equity of Fortis Bank Nederland (holding) N.V, while Luxembourg’s government spent €2.5b in Fortis Banque Luxembourg S.A., first as a mandatory convertible loan that on 15 December 2008 gave the government a 49 percent stake.

On 3 October 2008, the Dutch government assumed full control over Fortis’ Dutch operations (including ABN Amro), leaving the Belgian side vulnerable to investor panic. On 6 October the Belgian government purchased €4.7b in shares, giving it 99.93 percent ownership. The Belgian government negotiated the sale of 75 percent of its Belgian operations to French bank BNP Paribas. BNP also acquired Fortis’ international insurance activities. In addition, the French bank would obtain 66 percent of Fortis Bank Luxembourg. The Belgian and Luxembourg governments retained blocking minorities of 25 and 33 percent, respectively, and the Belgian government obtained a 10 percent stake in BNP Paribas and the Luxembourg government 1.4 percent (The Irish Times, 6 October 2008). Emergency liquidity assistance from the NBB continued until 9 October and at its height equaled €51.3b on 3 October 2008 (NBB 2009, p30). In addition, in November 2008 the Belgian federal government guaranteed up to €150m to Fortis for interbank transactions.

The Fortis rescue was controversial and contributed to the fall of the government of Yves Leterme in December 2008 over charges of political meddling. On 12 December 2008 the Brussels Court of Appeals ruled that the Dutch and Belgian governments had to submit the sale of the shares of Fortis to BNP Paribas to a vote of the shareholders. In February 2009 shareholders voted to block the sale to BNP Paribas. This opened the prospect that the bank would be nationalized and the Belgian government would assume bank liabilities over four times its GDP. One analyst noted, "Fortis is a big bank in a small country: the Belgian government's liabilities are already onerous" (The Daily Telegraph, 12 February 2009).

Another deal was hammered out in March 2009 in which the net asset value was lifted by €510m and the cash position by €1bn over the deal that was rejected last February. BNP Paribas would still assume a 75 percent stake in Fortis, which would then buy a 25 percent stake in Fortis Insurance Belgium from the former parent company, Fortis Holding, with financing guaranteed by BNP. Thus Fortis Holding could continue to be active in insurance whereas the banking sectors in Belgium and Luxembourg became part of BNP.
Finally in April 2009 the proposal passed with 72.99 percent, despite some shareholders reacting angrily by throwing their shoes at Fortis management (New York Times, 29 April 2009). BNP would acquire 75 percent of Fortis Belgium, and the Belgian government would keep 25 percent. A structured credit portfolio was transferred by Fortis to BNP Paribas, which contained an additional Protocole d’Accord for almost €2b, €1b of which substituted redemptions from 31 August 2008 onwards. The new agreement thus increased the value of the SPV from €10.4b to €11.4b. The Belgian government also guaranteed the losses due to toxic assets up to €1.5b, provided that Fortis covered the first €3.5b of losses. Finally, the Belgian government committed to recapitalizing Fortis for up to 3 years and €2b.

This bailout was shortly followed by the need to save Dexia SA. Dexia’s CDS spread rose after investors lost confidence due to its activities in the US, including its monoline activities of Financial Security Assurance (the American monoline insurance subsidiary of Dexia, Credit local de France), American securitized mortgages and later on the collapse of AIG (IMF 2009: 11; NBB 2009: 11). Moreover the Dexia group had difficulty refinancing once Lehman Brothers collapsed, due to its dependence on wholesale funding markets for financing (NBB 2009: 11). On 30 September 2008 a total of €6.4b were spent by the Belgian, French and Luxembourg governments. On the Belgian side, the federal government spent €1b, the regional government of Flanders invested €500m, that of Wallonia €350m, and the Brussels Capital region another €150m. Finally, Belgian institutional shareholders pumped in €1b. This support was buttressed on 9 October 2008 when the three governments guaranteed up to €150b worth of interbank and institutional deposits and financing, in addition to a new bond issuance aimed at institutional investors. On 14 November Dexia announced the sale and purchase agreement with monoline bond insurer Assured Guarantee for the sale of FSA Holdings (with the exception of its Financial Products activity done by FSA Asset Management) (NBB 2009: 11). After obtaining authorization by the European Commission on 19 November 2008, a formal agreement that guaranteed up to €90.75b (out of the €150b) was signed.

Furthermore, on 14 November the Belgian and French governments guaranteed Dexia’s option for FSA Asset Management, the Dexia subsidiary that had been excluded in the sale of FSA to the US monoline insurance company, Assured Guaranty. In order to limit the latter from the risks related to FSAAM products, Dexia created an option in favor of FSAAM that permitted it to sell all or part of this portfolio to Dexia (worth $16.5b). Both the Belgian and French governments provided guarantees for Dexia’s obligations under this option beyond the first loss of $3.1b that exceeded its then-reserve of $1.4b.

Dexia’s troubles had important spillover effects. The CBFA was required to intervene in Ethias Insurances, a result of the declining share prices of the Dexia bank of which Ethias controlled 5 percent. On 20 October 2008 the governments of Belgium, Wallonia and Flanders agreed to give Ethias €1.5b, provided that it fully restructured its insurance business and that the respective governments would each gain 25 percent plus one share in the company. In addition, Gemeentelijke Holding NV requested assistance from Belgium’s regional governments via a government guarantee in order to acquire the loans.
it needed to pay for its share in the necessary capital increase of Dexia. The Flemish government provided a guarantee of €200m, the Wallonian government €140m and the Brussels government €60m.

A week later on 27 October 2008, the Belgian government recapitalized by €3.5bn the KBC Bank NV-SA. KBC used this to augment its core Tier 1 capital in the banking business by €2.25bn and to increase the capital base of its insurance segment by €1.25bn. Although its capital and liquidity positions were more favorable than its counterparts, KBC’s exposure to emerging markets in central and Eastern Europe made government recapitalization necessary once the financial crisis spread eastwards. In addition, the Lehman Brothers collapse contributed to worsening financial conditions in wholesale markets more generally, and a hike in its CDS premium in October after Moody’s downgraded a series of collateralized debt obligations created by KBC Financial Products (NBB 2009: 12). In exchange, KBC granted the Belgian government €3.5b worth of non-transferable, non-voting core capital securities. In addition, the Belgian government obtained the right to participate in KBC’s operations with the nomination of 2 members of its board of directors in addition to Belgian state representatives on the Audit Committee, the Remuneration Committee and the Nomination Committee.

The Flemish regional government also provided funds worth €2bn on 22 January 2009 after KBC’s share price dropped as a result of the downgrading of some structured products in its portfolio. Both the funds of the Belgian federal government and the Flemish regional government were to increase its core tier 1 capital. Moreover on 13 May 2009 the Belgian government and KBC came to an agreement of €22.5bn in asset relief, with the Belgian government assuming responsibility for 90 percent of default risk going beyond a set first loss (NBB 2009: 32).

Beyond actions targeted towards specific institutions, the Belgian government also proposed new legislation and regulations in order to stem the capital outflows. On 19 September 2008, the BFIC announced that as of 21 December 2008 new rules on short selling would be in effect. In October additional laws that added to pre-existing laws under the Belgian Credit Institutions Supervision Law, the Insurance Undertakings Supervision law, the Investment Services Law and the Financial Sector and Financial Services Supervision law were passed in which state guarantees were enacted for credit, insurance and other financial institutions.

On 16 October 2008 a temporary guarantee scheme was created in order to assist the refinancing of credit institutions and financial holding companies on the interbank and wholesale markets. The guarantee can be used for all financed that are raised by the receiving institution in order to refinance itself with credit institutions and institutional counterparties, which could comprise bonds and debt instruments issued to institutional investors, if the borrowings mature prior to 31 October 2011. Therefore it includes interbank deposits, deposits by fiduciaries, central bank deposits, institutional deposits, commercial paper, certificates of deposit and negotiable medium-term notes. In turn a payment is made that is supposed to reflect its financial value.
On 14 November 2008, protection for Belgian depositors was increased to €100,000, retroactive from 7 October (previously only the first €20,000 euros in bank accounts were backed by government guarantees).

The government also set out to reform its own institutions, with the formation of the This committee offered a threefold explanation for Belgium’s difficulties during the financial crisis: it plays host to numerous international financial institutions, given its status as headquarters; the aforementioned high savings rate led to a search for investment returns, including American assets, that have declined in value; Belgian banks play a large role in the Belgian economy, with assets larger than that of national GDP. Moreover it was critical of the existing structure of Belgian financial system, notably arguing for “a true macro-prudential supervision”, the need for a more transparent selection of executive committee members of the CBFA, and augmenting the authority of the supervisory board.

In January 2009 the Belgian parliament voted for a law extending the range of measures that can be undertaken by the CBFA (and the King) in case financial stability becomes threatened. This follows measures undertaken by other EU governments to strengthen the ability of governments to intervene when a banking or insurance company faces undergoes severe difficulty. The CBFA can now suspend the activities of banking and insurance companies, and the King can intervene (with the transfer, sale or contribution of assets, for example) in order to rescue credit, insurance or settlement institutions (NBB 2010, pp29-31).

In May 2009 the CBFA refined its liquidity risk management approach with the introduction of stress test observation ratios for the liquidity position of financial institutions that demonstrated Belgium’s conformance to Basel II Pillar II guidelines (NBB 2010, p58).

Table 2 Belgian government intervention during the financial crisis

<table>
<thead>
<tr>
<th>Date</th>
<th>Financial institution</th>
<th>Type of intervention</th>
<th>Other governments?</th>
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<tbody>
<tr>
<td>29 September 2008</td>
<td>Fortis</td>
<td>Recapitalization of €4.7bn for 49% share</td>
<td>Netherlands, Luxembourg</td>
</tr>
<tr>
<td>30 September 2008</td>
<td>Dexia SA</td>
<td>Recapitalization from the federal government (€1bn), regions (Flanders €500m, Wallonia €350m, Brussels Capital €150m)</td>
<td>France, Luxembourg</td>
</tr>
<tr>
<td>9 October 2008</td>
<td>Dexia</td>
<td>Guarantee (with LU and FR)</td>
<td>Luxembourg, France</td>
</tr>
<tr>
<td>Date</td>
<td>Company</td>
<td>Action Details</td>
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<tr>
<td>October 2009</td>
<td>Ethias Insurances</td>
<td>Recapitalization of €1.5bn from federal, Walloon and Flemish governments in exchange for a 25% share (each) plus 1; restructuring of insurance sector</td>
<td></td>
</tr>
<tr>
<td>27 October 2008</td>
<td>KB C</td>
<td>Recapitalization of €3.5b, with right to nominate 2 members of board of directors</td>
<td></td>
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<tr>
<td>November 2008</td>
<td>Financial Security Assurance</td>
<td>Guarantee of assets managed</td>
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<tr>
<td>November 2008</td>
<td>Gemeentelijke Holding NV</td>
<td>Guarantee from regional governments to finance its share in Dexia’s capital increase</td>
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<tr>
<td>5 November 2008</td>
<td>Fortis</td>
<td>Guarantee for interbank transactions up to €150m</td>
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<tr>
<td>14 November 2008</td>
<td></td>
<td>Belgian depositors’ protection raised to €100,000</td>
<td></td>
</tr>
<tr>
<td>15 January 2009</td>
<td>Luxembourg Kaupthing</td>
<td>Loan of €160m to LU government for restructuring to guarantee savings of Belgian nationals</td>
<td></td>
</tr>
<tr>
<td>22 January 2009</td>
<td>KBC</td>
<td>Flemish regional govt injects €2b</td>
<td></td>
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<tr>
<td>27 March 2009</td>
<td>NMBS Holding</td>
<td>Guarantee for its sale and lease back agreements with AIG</td>
<td></td>
</tr>
<tr>
<td>14 May 2009</td>
<td>KBC</td>
<td>Guarantee of asset</td>
<td></td>
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</table>
Although it entered the crisis in a favorable position, Belgian banks were severely affected by the financial crisis, resulting in large capitalization losses and contractions in their balance sheets (see Figure 4). All of the major banks witnessed steep drops in share prices when markets questioned their exposure to risky assets and state of solvency. Belgian banks actually performed worse than similar European banks in terms of market capitalization (IMF 2010, p39). On the positive sign, the ratio of nonperforming loans was lower for Belgian banks than for their peer banks in Europe, though loan losses continued to rise (IMF 2010, p44).

**Figure 4** Net profits of major bancassurance groups

![Net profits of major bancassurance groups](image)

Source: NBB 2009: 35

From 2003-2007, the large Belgian bancassurance companies expanded into foreign markets and increased their trading activities in wholesale markets. By the final quarter of 2008, deleveraging had begun with the separation of Fortis Bank Nederland, which resulted in a decline from €1422.1b at the end of 2008 to €1190.5b a year later (NBB 2010: 35).
Perhaps the largest change that has occurred as the result of the financial crisis is that the need for the infusion of foreign capital to bail out the banking system has left Belgium in the position of a host country supervisor rather than a home country, as seen in Figure 5 (High Level Committee 2009). In addition, the business models of the major banks have changed: Fortis was sold to BNP Paribas and has seen a shift back to separate banking and insurance bodies, as opposed to its pre-crisis integrated model. KBC and Dexia underwent major internal reforms (requiring EU authorization), including a reduction of risk and the strengthening of its core and domestic retail franchises (IMF 2010: 47).

On the other hand, we also see some continuity despite the financial crisis. Two years after the failure of Lehman Brothers, Belgian banks are still highly leveraged (IMF 2010: 11).

Belgian Financial Regulation and the Varieties of Financial Capitalism

The literature on varieties of capitalism posits at least two main categories, a liberal model and a coordinated one (Hall and Soskice). Schmidt (2002) argues for the existence of a third, state-led capitalism. The type of institutions we find within these categories should be complementary, to the extent that a coordinated market economy (such as Belgium) should have similar structures across economic spheres. Therefore a coordinated market economy should engender patient capital and be dominated by banking. Indeed, Belgium did see an important

The Belgian supervisory system was based on a cooperative or twin peaks model in which the central bank controls monetary policy as well as securities clearing and
settlements, whereas the CBFA was responsible for micro-prudential supervision, market integrity and consumer protection. In the wake of the financial crisis, in December 2009 the government formed the “High Level Committee for a New Financial Architecture” headed by Alexandre Lamfalussy to analyze the causes of the financial crisis in Belgium and to suggest reforms.\(^4\)

The CBFA oversees over 200 financial institutions, creating a workload that has been described as “so severe that controls and verifications tend to be implemented in very much of a ‘ticking-box’ style.” In addition, “the present structure of the CBFA does not allow for effective identification of…conflicts of interest…when conflicts arise between micro-prudential supervision and consumer protection, the organisational modalities of the CBFA lead to a bias of the final decision in favour of the former” (High Level Committee 2009: xx).

The Financial Stability Committee, charged with analyzing the stability of Belgium’s financial system, enjoyed an advisory role. Though there were hopes that its analyses would lead to concrete policy changes by either the NBB or CBFA (from which its executive committee was formed), it had no formal powers. The High Level Committee also found its analytical work to be unsatisfactory, arguing that it lacked “a holistic approach towards risk analysis…the rather large composition…was not conducive to in-depth treatment of financial stability issues, while the lack of clarity on the legal provisions concerning confidentiality issues contributed to the reluctance to share confidential information on individual firms, especially listed ones. It is therefore not surprising that the FSC was not able to identify a forthcoming crisis, nor to effectively coordinate the management of the crisis once it erupted.” Indeed, the Belgian financial system lacked supervision on a systemic level.

The Belgian supervisory authority is set for reorganization. In 2011 the Belgian organization will resemble those of Germany and the Netherlands as the authorities of the NBB and the CBFA will be combined. The new integrated model will give responsibility for the stability of the financial system as well as the supervisory power over the individual financial intermediaries to the NBB. A different institution will take over the preservation of market integrity and consumer protection. Therefore the NBB will control the stability of the clearing and settlements infrastructures as well as supervise the institutions within (NBB 2010: 93).

Conclusions

The Belgian financial system began in a seemingly strong position. Its major bancassurance groups were well capitalized and had made relatively conservative investments. They were not heavily exposed to subprime mortgages, asset-backed securities or collateralized debt obligations but relied more heavily on bank credit and mortgages. Stress tests done shortly before the crisis confirmed its robustness. These features had protected it from having ever suffered a systemic crisis prior to September 2008.

Nevertheless it was highly financialized and leveraged. Moreover the high savings rate of Belgian households meant that the bancassurance groups were searching for investment opportunities, which in recent years led them to Eastern Europe and the USA, including greater investment in wholesale markets.

While Belgium’s financial system retained some characteristics of its traditional bank-based system, the rising level of financialization brought upon it increased risk and vulnerability that its opaque regulatory structure could not manage. Its large capital stocks proved to be an insufficient buffer against its increasingly highly leveraged asset balance. The traditional distinction between bank-based and market-based system must therefore be reevaluated in order to gain a more complete understanding of the impact of financial structures.