**Special report of the accredited statutory auditor in relation to the submission of the application file in view of obtaining the authorization of the National Bank of Belgium in accordance with Article 36bis §1bis of the Royal Decree of 23 September 1992**

**Subject**

This special report has been prepared in the context of the submission of the application file by *[identification of the entity]* (the “Company”) in view of obtaining the authorization of the National Bank of Belgium (the “NBB”) in accordance with Article 36bis §1bis, based on the terms as set out in circular NBB\_2021\_20 of 5 October 2021 relating to the practical rules for the application of Article 36bis of the Royal Decree of 23 September 1992 on the annual accounts of credit institutions, investment firms and management companies of undertakings for collective investment (the “Royal Decree of 23 September 1992”), as amended by the Royal Decree of 29 August 2021 (the “Application File”).

It is the Board of Directors’ and senior management’s responsibility to ensure that the Company complies with the provisions of Article 36bis of the Royal Decree of 23 September 1992, as amended by the Royal Decree of 29 August 2021, prepares the Application File in accordance with the requirements listed in circular NBB\_2021\_20 of 5 October 2021 and complies with the conditions and formalities to be fulfilled to obtain and maintain an authorization granted by the NBB.

**Legal and regulatory framework**

Institutions that want to apply Article 36bis to macro-hedging or securitization transactions, need to apply for authorization from the NBB by means of the submission of an Application File in accordance with circular NBB\_2021\_20. It is to be noted that, for transactions concluded as part of a securitization without taking on additional risk, the institution needs to obtain a specific authorization for each securitization transaction.

**Guidance (transitional period only)**

The Royal Decree of 29 August 2021 provides that any individual derogations from Article 36bis granted by the NBB (or previously by the CBF/CBFA) pursuant to Article 38 of the Royal Decree of
23 September 1992 remain valid until 31 December 2022. Institutions having obtained such derogations must, if they wish to continue to apply macro-hedging after 31 December 2022, apply for authorization from the NBB by 31 March 2022 at the latest by means of the submission of an Application File in accordance with Chapters 5 and 6 of the circular NBB\_2021\_20.

When the Application File relates to existing derogations with respect to macro-hedging transactions initially obtained before 1 January 2016, the Application File needs to consist of the information as listed under section A below. In addition to these elements, the following needs to be added:

* evidence with respect to the hedge effectiveness testing performed during the two accounting quarters prior to the submission of the application file; and
* scheme B annex XXIV drafted based on the situation at the end of the last semester prior to the submission of the application file.

When the Application File relates to existing derogations with respect to securitization transactions initially obtained before 1 January 2016, the Application File needs to consist of the information as listed under section B below.

When the Application File relates to existing derogations with respect to macro-hedging transactions or securitization transactions obtained after 1 January 2016, the Application File needs to consist of an updated version of the initial file submitted to obtain the derogation (in accordance with the Uniform Letters of the Bank of 18 November 2014 and 29 December 2015 and the communication NBB\_2020\_32), considering the new conditions laid down in the amended Royal Decree.

**Guidance (for new macro-hedging or securitization transactions)**

1. ***Information to be included when the Application File relates to macro-hedging transactions***

The Application File needs to consist of the following elements:

* appropriate supporting information documenting the eligibility of the transactions and instruments in accordance with article 36bis §1bis;
* practical implementation of the governance and documentation and measurement of hedge effectiveness as laid down in Sections 2 and 3 of Chapter 2 of the circular, including an action plan in the event the limits are exceeded;
* description of the entity’s overall interest rate risk management strategy/strategies, including at least the methods of identifying the economic risks to be hedged and the economic hedging methods in place or planned, specifying for each specific hedged and designated risk the underlying hedged instruments and the precise nature of the hedging instruments used;
* reasoned description of the procedures that will be implemented and the methods and criteria that will be used to calculate and monitor the prospective and retrospective effectiveness tests;
* indication of the portfolios/books where the relevant derivatives will be booked and the corresponding IAS/IFRS strategy if applicable at the consolidated reporting level;
* accounting treatment of the instruments concerned, including in the case of test failure and reclassification; and
* any other information enabling the NBB to verify that the above-mentioned conditions are met.
1. ***Information to be included when the Application File relates to securitization transactions***

The Application File needs to consist of the following elements:

* justification that these forward interest rate transactions overall do not lead to an effective increase in interest rate risk (at the consolidated level) before and after the conclusion of derivatives between the credit institution and the consolidated SPV at any times for the entire duration of the transaction (neutrality condition);
* demonstration that these transactions are part of the overall interest rate risk management and, as such, meet the governance criteria as taken up in Section 2 of Chapter 2 of the circular;
* documentation of the specific monitoring implemented for these transactions, which allows to verify their ongoing neutrality in relation to the institution’s overall interest rate risk (no deterioration);
* demonstration that the institution at all times has sufficient resources in terms of systems and competences to perform this specific monitoring with regard to both underlying risks and accounting entries; and
* any other information enabling the NBB to verify that the above-mentioned conditions are met.

**Engagement**

In accordance with circular NBB\_2021\_20, the Application File must be accompanied by a special report prepared by the accredited statutory auditor specifying:

* that the information provided by the institution in its application file is accurate and complete;
* whether the accredited statutory auditor is aware of any facts or information that might call the institution’s statements into question; and
* *[only for entities having obtained a derogation with respect to macro-hedging before 1 January 2016: that the effectiveness tests were indeed conducted during the transitional period and that these tests did not reveal any structural problems that would call into question the effectiveness of the hedge in place and which would have resulted in repeated non-compliance with the limits of the new policy.]*

**Procedures performed**

Based on the above requirements, we assessed the Application File by performing the following:

* for existing derogations: obtaining the original derogation(s), to determine whether it is (they are) dated before or after 1 January 2016;
* obtaining the Application File prepared by the Company and verifying whether all (expected) elements are addressed in the file in accordance with circular NBB\_2021\_20;
* for macro-hedging transactions: performing a critical reading of the description including the elements relating to governance and documentation and measurement of hedge effectiveness applied for interest rate risk purposes and identifying any inconsistency with the information received in the context of the statutory audit and the procedures on the prudential returns;
* for securitization transactions: performing a critical reading of the description including the elements relating to governance, monitoring and documentation and demonstration of the neutrality condition and identifying any inconsistency with the information received in the context of the statutory audit and the procedures on the prudential returns;
* obtaining and inspecting the supporting evidence with respect to the elements included in the Application File (eligibility, governance, documentation, strategy, procedures, methods, monitoring, etc.) and identifying any inconsistency with the information received in the context of the statutory audit and the procedures on the prudential returns;
* for macro-hedging transactions: obtaining evidence of the risk-reducing characteristics of the macro-hedging strategies (based, for instance, on the 90.30 table or the IRRBB tables with or without the hedges);
* for securitization transactions: obtaining evidence of the interest rate risk neutral characteristics of the securitization transaction, by comparing the interest rate risk before and after the application of the derivatives between the entity and the securitization vehicle (for example based on 90.30 tables or IRRBB tables with and without the derivatives involved);
* understanding the (macro) hedging strategy/strategies and the corresponding IAS/IFRS strategy if applicable at the consolidated reporting level;
* performing a walkthrough of the process and testing of the design and the implementation of the key controls applied;
* for macro-hedging transactions: analyzing the suitability of the method used for the retrospective and prospective hedge effectiveness test and assessing the complete and accurate character of the data used and the computation applied by the Company *[only applicable to existing derogations: This analysis will consider whether the hedge effectiveness test was met during the two preceding quarters (observed at the end of each reporting period used by the Company)]*;
* reading and assessing whether the accounting principles defined by the Company are compliant with the revised Article 36bis (together with the requirements included in the circular) and address the accounting treatment when the hedge does not meet -or no longer meets- the conditions of Article 36bis §1bis (as described in Chapter 3 of the circular);
* as far as financial data are concerned, reconciling the data with the general ledger and/or the accounting and financial systems *[if possible, please also refer to the audit procedures performed if 31 December 2021 data are included]*;
* reviewing and assessing the Application File for accuracy based on the above procedures and our knowledge obtained in the context of the statutory audit and the procedures on the regulatory returns *[Inconsistencies and/or inaccuracies with a possible significant impact on the complete and accurate character of the Application File will be reported to the NBB as part of this report. To facilitate the review and assessment referred to above, we have included in appendix 1 the list of key points to be considered]*;
* obtaining a specific representation letter;
* discussing our findings and recommendations[[1]](#footnote-1) (if any) with the relevant management bodies, being *[to specify which management bodies]*;
* *[to complete with other relevant procedures based on the professional judgement of the accredited statutory auditor]*.

**Limitation**

The procedures mentioned above have been performed in our capacity of accredited statutory auditor of *[identification of the entity]* in the context of the submission of the Application File, on the basis of the requirements as set out in circular NBB\_2021\_20. Because the above procedures do not constitute either an audit or a review in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the information included in the Application File.

Had we performed additional procedures, or had we performed an audit or review of the Application File in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

**Findings and recommendations**

Based on the performance of the above-mentioned procedures, we would like to report the following findings and recommendations:

*[Listing of the findings and recommendations with respect to the Application File]*

**Conclusions**

Based on the procedures described in this report and taking into account the above findings and recommendations:

* in our opinion the Application File is, in all significant aspects, accurate and complete in accordance with the terms set in circular NBB\_2021\_20 and taking into consideration the facts and circumstances of the Company;
* nothing has come to our attention that causes us to believe that the statements of *[identification of the entity]* in the Application File might be called into question; and
* *[only if the original derogation was obtained before 1 January 2016: in our opinion, in all significant aspects, the hedge effectiveness tests were indeed conducted during the transitional period and that these tests did not reveal any structural problems that would call into question the effectiveness of the hedge in place and which would have resulted in repeated non-compliance with the limits of the new policy.]*

These conclusions have been formed on the basis of, and are subject to the inherent limitations outlined above.

**Restriction on use and distribution**

This report is intended solely for the use in the context of the submission of the Application File by *[identification of entity]* to the National Bank of Belgium and may not be used for any other purpose.

This report may not be provided to any third party without our prior written consent.

*[Place, date and signature,*

*The accredited statutory auditor,*

*Name]*

**Appendix 1:**

**Key points to be considered based on the NBB requirements listed in circular NBB\_2021\_20**

***Eligibility of the transactions and instruments***

In order to be considered as eligible, the transactions should have the objective:

* to reduce the interest rate risk, as defined by the EBA, to which the entity is exposed; or
* to hedge highly probable future cash flows, as justified and documented by the entity

Transactions concluded to manage the interest rate risk without taking on additional risk and which are concluded as part of a securitization carried out in the context of liquidity risk management with a vehicle consolidated by the credit institution , are considered eligible, when:

* the entity is able to demonstrate that the transaction does not increase the interest rate risk on a consolidated level
* the entity can demonstrate that the transactions are part of the overall interest rate management and, thus, comply with the relevant governance criteria
* the entity is able to document the specific monitoring activities in place to permanently verify the neutral character of the transaction with respect to the consolidated interest rate risk of the entity
* the entity has -at all times- the ability in terms of skills and systems to perform the monitoring relating to the underlying risks and the accounting schemes

Term or interest rate options (derivatives) are eligible, with the exception of written options, due to the unlimited risk to which they expose the entity

Written options, combined with other instruments such as collars (tunnels), are eligible as far as the entity can demonstrate that these are not increasing the interest rate risk

***Governance***

The management committee (“comite de direction / directiecomité”) approved the designated transactions, the limits and the governance, including the internal control and the internal audit, with respect to the management of these positions

The management committee periodically evaluates, at least semi-annually, the transactions and the associated risks, taking into account the risk and the volatility of the positions

The entity complies with the requirements as stated in the circular NBB\_2019\_18 relating to the management of the interest rate risk of the non-trading activities

The entity has the required resources and systems to correctly reflect the hedging transactions in the statutory accounts, in accordance with the RD of 23 September 1992

The management committee did approve the action plan in case of hedging ineffectiveness

Once a year, the management committee provides its evaluation of the interest rate management in its internal control report, as foreseen by circular NBB\_2011\_9[[2]](#footnote-2)

***Documentation***

Detailed documentation is maintained on the internal organization for managing and monitoring interest rate risk, including the institution’s policy on interest rate risk management (36bis, § 1bis, first paragraph, 3°)

At the origin of the hedging transaction, the is a formalized identification and documentation in place describing the hedging relationship and objective with respect to the risk management and the hedging strategy

The hedge is expected to be highly effective in compensating for changes in fair value or cash flows, in accordance with the initial documented risk management strategy

The hedge effectiveness can be reliably measured, meaning that the fair value or the cash flows of the hedged item and the fair value of the hedging instrument can be reliably measured

The hedge is continuously evaluated, determining whether the hedging has been highly effective during the periods for which the hedge was designated

***Strategy***

The description of the strategy(ies) of the entity with respect to the global management of the interest rate risk should at least consist of the following:

* the methods used to identify the economic risks that need to be hedged
* the methods applied or to be applied for hedging, specifying the hedged instruments and the specific characteristic of the hedging instruments for each hedged risk

***Prospective and retrospective effectiveness testing***

The entity provides a dedicated description of:

* the procedures that will be in place
* the methods and criteria that will be used

to measure and monitor the prospective and retrospective effectiveness testing

***(If applicable) Securitization transactions***

The entity needs to demonstrate that the global interest rate risk will not be increased as a result of the transaction, by comparing the interest rate risk before and after the application of the derivatives between the entity and the securitization vehicle. This demonstration may be made in various ways, for example based on 90.30 tables or IRRBB tables with and without the derivatives involved

***Accounting aspects***

The entity should identify the portfolios/books in which the concerned derivatives will be booked

The institution has an adequate internal organization in place (governance conditions) for managing and monitoring interest rate risk, that allows the related transactions to be accurately represented in the financial statements (36bis, § 1bis, first paragraph, 2°) – Transparency obligation on the information to be included in the notes to the financial statements (Scheme B) – Chapter 4 of the NBB circular

The entity should indicate the corresponding IAS/IFRS strategy if applicable at the level of the consolidated reporting (or at solo level, if the entity does not prepare consolidated accounts)

The entity needs to describe the accounting schemes of the concerned instruments, including the accounting scheme in the case of hedging ineffectiveness

***Hedge effectiveness testing***

The hedging transactions are highly effective, and the institution has an appropriate internal organization and adequate methods, criteria and monitoring tools to verify the effectiveness of the hedge and to adopt the necessary corrective measures when this effectiveness is no longer assured on both a retrospective and a prospective basis (36bis, § 1bis, first paragraph, 4°)

The entity needs to demonstrate that the hedge has been continuously evaluated on the basis of effectiveness tests during the two accounting quarters prior to the submission of the application file

***Disclosures***

The entity drafted Scheme B annex XXIV based on the situation at the end of the last semester prior to the submission of the application file

1. In case of findings and recommendations, it is required to receive the overview with remedial corrective actions drafted by the Company, including deadlines indicating when the finding will be resolved, and to attach this overview to this special report [↑](#footnote-ref-1)
2. In the case where the internal control report was prepared before the Application File, the auditor will enquire whether the management committee has planned to include this evaluation in the next year’s internal control report [↑](#footnote-ref-2)