Buffers,
business models,
risk management
and governance

DNB Supervisory themes 2012

De Nederlandsche Bank
Eurosysteem

Contents

Preface

The restoration of financial buffers, the sustainability of business models, improved risk management, supervision of governance, financial sector integrity and improved data quality are major themes underlying DNB's supervision in 2012. The theme-driven approach constitutes an integral element of DNB's supervisory effort. This approach is especially effective in tackling problems or addressing developments that span a large number of supervised institutions and consequently call for an approach transcending the level of individual institutions.

The purpose of this brochure is twofold. First, it aims at informing the general public about thematic supervision. Secondly, it serves to inform the supervised institutions about DNB's priorities in 2012 under this supervisory approach, making clear what they may expect from the supervisory authority and what the latter expects of them. This is in line with the new approach, which focuses on influencing behaviour. DNB will hold discussions with the financial sector about its overall findings and will, where necessary, provide guidance in the form of policy rules and good practices.
Whenever there is reason to do so, DNB will take enforcing action at individual institutions. DNB will report on the effects of its theme-driven supervision in its 2012 annual report.

DNB views the umbrella organisations as important discussion partners and, where possible, will cooperate closely with other supervisory authorities, including in particular the Netherlands Authority for the Financial Markets and the Financial Expertise Centre.

We hope and expect that this brochure will provide an incentive for institutions to take up the challenge.

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1 Introduction

The European debt crisis and the disappointing economic recovery pose a threat to the soundness of financial institutions and to financial stability. The financial sector in the Netherlands is facing a period of exceptionally high uncertainty, with new developments making themselves felt in rapid succession.

At this juncture, a major part of the supervisory effort ensues directly from the financial crisis. This is also true of the theme-driven supervisory approach: the supervisory themes address potential vulnerabilities at supervised institutions and sector-wide risks as they have been identified earlier in the Overview of Financial Stability in the Netherlands of November 2011. In addition, the implementation of new regulations and new supervisory points of focus as formulated in response to the financial crisis in DNB Supervisory Strategy 2010-2014 and the Action Plan Change in Conduct of Supervision constitutes a major element of the theme-driven supervisory approach. In part, the themes for 2012 build on last year's findings, as witnessed by the continuing focus on the restoration of financial buffers, business models, risk management, supervision of governance, conduct and culture, and improved data quality. Furthermore, the financial sector's integrity, including the fight against cybercrime, will be given special attention.

Thematic supervision, supplementing as it does institution-specific supervision, has proved its usefulness, also in crisis situations. Such situations call for a watchful supervisory authority, which does not treat financial institutions as separate islands but instead views them in their interrelationships, compares them with each other, identifies outliers, recognises and stimulates best practices, and assesses the impact of macro-economic developments at the sectoral level. Hence, DNB will devote a significant proportion of its supervisory capacity to this supervisory approach. •

2 Financial sector to improve its resilience

Financial institutions operate in an uncertain environment marked by grave risks. The new supervisory rules under Basel III and Solvency II enhance banks' and insurers' resilience by imposing stricter requirements on the size and quality of the capital buffers. Systemic banks, too, will have to comply with stricter capital requirements, and the possibilities of orderly winding-up in the event of failure will have to be improved. Within DNB's supervision, migration to new supervisory frameworks constitutes a major issue.

2.1 Banks: implementation of Basel III / CRD IV and SIFI framework

The crisis has shown that banks must strengthen their solvency and liquidity. To that end, Basel III will be implemented in stages from 2013 onwards. Where the Netherlands is concerned, it is especially the European implementation of Basel III which is essential. At the European level, Basel III will be incorporated in the Capital Requirements Directive IV (CRD IV), which is expected to take effect on 1 January 2013. This year will be dominated by the relevant preparations, both as regards the adjustment of national legislation and regulation and the banks' migration towards compliance with the new requirements. It is essential that the Dutch banks should ensure timely compliance with the new requirements. In 2011, DNB requested the banks to submit their migration plans, with the appropriate targets and envisaged measures, and subjected them to an assessment. The assessment has shown that banks are moving in the right direction, but also that many banks still have a long way to go and sometimes proceed on the basis of unduly optimistic assumptions. In 2012, DNB will monitor progress in the implementation of the planned measures, provide feedback to the sector and, where necessary, instruct individual institutions to tighten up their targets and measures. In addition, acting in close collaboration with the Ministry of Finance, DNB will address the heavy task of adjusting the relevant legislation and regulation.

At the international and the national level, DNB will continue to work in 2012 on strengthening the supervision of systemic institutions. Measures are called for to mitigate the systemic risk posed by these institutions and to limit the (implicit) guarantees on the part of the public authorities. Recommendations have been issued by the Financial Stability Board, aimed at reducing risk and impact of the failure of systemic institutions. DNB will apply these recommendations to all systemic banks established in the Netherlands. In 2011, all the systemic banks under DNB's supervision started setting up recovery plans. In these plans, the banks themselves describe the measures which they may take to counter imminent threats. In addition, for a number of institutions, DNB has established crisis management groups, consisting of prudential supervisors, central banks and finance departments of the countries directly concerned. No later than mid-2012, the recovery plans will be finalised. Furthermore, DNB will proceed by drawing up resolution plans, describing measures to be taken by the authorities in order to ensure rapid and orderly winding-up of a bank in the event of failure. Rapid and orderly winding-up is taken to mean the dismantling of the bank without systemic effects and risks for taxpayers, while continuing vital functions.

2.2 Insurers: Solvency II

In 2014, the new supervisory framework for insurers, Solvency II, will be fully implemented. Solvency II marks the transition to a risk and market-value-based solvency regime, including integrated group supervision.
The Solvency II legislation rests on three pillars: (i) risk quantification, (ii) risk management and (iii) risk transparency. In addition, specific attention is paid to groups, internal models and the supervisory process. Finally, in the Netherlands a special regime, Solvency II Basic, will be introduced for insurers which do not qualify for Solvency II but are yet subject to supervision. In 2012, DNB will work out the regime for Solvency II Basic insurers in collaboration with the Ministry of Finance and will present the results to the sector for consultation.

The preparations for the introduction of Solvency II will be continued with full vigour in 2012. Within the framework of Pillar I, the fifth Quantitative Impact Study (QIS) was conducted in 2010. In early 2011, the results of the study were shared with the sector; they can be found in Open Book Supervision (www.toezicht.dnb.nl). In 2012, as a sequel to QIS5, DNB will conduct a so-termed parallel run. In this context, insurers must, for the financial year 2011, submit returns using both the Solvency I and the Solvency II format.

In addition, in 2012 DNB will focus on the further preparations for and elaboration of Pillar II.
ORSA (Own Risk and Solvency Assessment) constitutes a key aid for insurers in internalising risk management and capital requirements under Solvency II and also serves as an indicator of the progress achieved in preparing for Solvency II. In 2011, DNB conducted a pilot ORSA with ten insurers. In 2012, the ORSA pilot will be rolled out sector-wide (‘dress rehearsal’). In 2012, DNB will also concentrate to a larger extent on the implementation of Pillar III, notably on the preparations for the reporting templates based on the final regulations.

Apart from offering a standard framework for the calculation of the risk-based Solvency Capital Requirement (SCR), Solvency II permits insurers to use an internal risk model for the calculation of the capital requirement. Such an internal model must be prevalidated by the supervisory authority. The criteria for approval are not statistical but relate to how the model is organisationally embedded in the insurer's risk management. The validation assessment is a complex, time-consuming and intensive process. That is why DNB permits insurers intending to use an internal model to take part in the preapplication. Such participation is important for both insurers and their supervisors as an exercise in preparing for the formal application for permission to use an internal model. The preapplication of internal models will be continued unabated in 2012.

2.3 Pension funds: elaboration of the supervisory framework for the new pension contract

The employers' organisations, the trade unions and the Cabinet have concluded an agreement about a new pension contract, under which pension risks will to a greater extent be borne by the pension scheme members. Whereas the employers' organisations and the trade unions are responsible for the substance of the pension contract, the design of the supervisory framework is the responsibility of the legislator. DNB and AFM advise on the elaboration of the supervisory framework, test its feasibility, conduct the necessary preparations and finally implement the framework. Effective supervision requires a sound supervisory framework with clear standards permitting effective enforcement, especially in the case of a contract which shifts risks to pension scheme members. This year, on the basis of the pension agreement, DNB will continue to contribute to the design of a supervisory framework for the new type of pension contract. In this light, the role of DNB as supervisory authority for the new pension system will also be defined. It might be noted in this context that the European Commission intends to change the European Pension Directive. DNB is involved in advising EIOPA about the change to the Directive as well as in the review of the pension agreement in the light of the current Pension Directive and the planned changes, to which the Cabinet has committed itself towards the Second Chamber of Parliament. •

3 Working towards a sustainable business model

How does a financial institution earn its income? Is an institution's business model sustainable? What happens if all institutions employ the same business model? Answering these questions improves the capability of the supervisory authority to identify potential problems at financial institutions at an early stage. Today's rapidly changing financial environment lends these questions added importance, because some activities might no longer prove profitable. In this context, banks' funding strategies also merit attention.

3.1 Banks: funding strategy

As a result of the European debt crisis, the funding of Dutch banks' is under pressure. Obtaining long-term funding is becoming more difficult, causing increasing recourse to short-term and secured funding. In the longer term, this gives rise to an ill-balanced funding structure and excessive asset encumbrance. Consequently, the Dutch banking system's funding structure constitutes a major focus of attention for DNB, not just at the present time but also in the long run. In 2011, DNB developed a policy in respect of the Internal Liquidity Adequacy Assessment Process (ILAAP) and, in that context, requested large numbers of data from about twenty banks. This produced a considerable amount of detailed information about banks' funding profiles.
The conclusions drawn from the data serve as input for the funding strategy theme. DNB is working on a view of Dutch banks' funding, which should establish the essentials of a sustainable and stable funding profile and lead to the formulation of prudential criteria, to be used by DNB in assessing banks' funding profiles. This will be done in the context of the annual ILAAP. In respect of the results of the assessment, DNB will provide feedback and, where necessary, encourage individual institutions to work towards a more sustainable funding profile.
In this respect, care should be taken to ensure that any restrictions on the manner of funding do not conflict with the banks' migration to Basel III.

3.2 Banks: mortgage loans market

The Dutch housing market is characterised by a high level of mortgage indebtedness, with high loan-to-value ratios and a high proportion of interest-only mortgage loans. As a consequence, many households are vulnerable to an economic downswing coupled with a further decrease in housing prices. Financial institutions could thus be faced with major losses in respect of their mortgage loan portfolios, affecting their solvency.
This is especially true of banks, a number of which have substantial mortgage loan portfolios on their balance sheets. It could also aggravate the funding problems described above, because mortgage loans are often used as collateral when obtaining funding. DNB wishes to

gain a better insight into the consequences of a decrease in housing prices and a rising number of mortgage loan defaults on the solvency of Dutch banks. To this end, DNB has begun a study, consisting of the collection and analysis of data, discussions and the elaboration of stress scenarios. Using the results as a basis, DNB will assess whether banks hold sufficient capital against the risks thus identified and will, where necessary, require improvements.

3.3 Insurers: profitability of life insurance origination

From the thematic investigation conducted by DNB in 2011 into the profitability of life insurance products of insurers, it appeared that, on a market-consistent basis (in conformity with Solvency II), certain products seemed unprofitable. If newly originated products are marketed for a prolonged period of time on an unprofitable basis, solvency may be affected. Furthermore, the investigation showed that, within the sector, many different bases and methods are still used for the valuation of newly originated products, often hampering a clear-cut comparison between insurers and product categories. A sound view of the degree of market-consistent valuation of newly originated products is essential if potential vulnerabilities are to be exposed. Also, this will help to ascertain which insurers successfully market certain product categories. Hence, based on its findings, DNB has drawn up a good practice and has published it on its website (under Open Book Supervision). DNB will ask the supervised insurers for information about the market-consistent valuation of certain newly originated products in 2011 in order to gain a better insight into the profitability of such origination.

3.4 Cross-sectoral: commercial real estate

Developments in the Dutch real estate market are downright worrying. Notably the Dutch office accommodation market is characterised by large-scale vacancies. This excess supply means that, over the next few years as well, office accommodation prices will likely remain under pressure. In the market for retail accommodation, a more mixed pattern is in evidence. For as long as counterparties are still able to meet their payment obligations, the resulting impact on financial institutions remains hidden. However, should this change, for instance as a result of the cyclical downswing, rapidly rising losses might well ensue. In 2012, DNB will conduct a further investigation into the risks which the commercial real estate market poses for banks, insurers and pension funds. Over the past few years, major efforts have already been made to chart the relevant exposure of banks, insurers and pension funds and to assess the risks attached to such investments. In that context, questions have arisen as to the valuation of commercial real estate. Hence, this year a sample study will be conducted into commercial real estate valuations, focusing in particular on vacancies, rent arrears, overdue maintenance, etc. Subsequently, on the basis of the results of this and other analyses, DNB will subject financial institutions' real estate exposure to stress tests, in which the indirect exposure through regular credits secured by real estate will also be considered. Depending on the results, DNB will seek to ensure that more capital is held against commercial real estate risks and that the valuation methods are tightened. •

4 Knowing, understanding and controlling risks

The crisis has shown that institutions' risk management was not nearly always sufficient to permit prudential risks to be identified in good time and to enable anticipatory action to be taken. Risk management constitutes an important link in the identification, measurement and assessment of the risks facing an institution and is, therefore, an important supervisory anchor. Sound risk analysis also requires that risk management is sufficiently embedded in the organisation and that, where necessary, adjustments are made. In its theme-driven supervision in 2012, DNB intends to focus in particular on the quality of the internal audit function at banks, and on the control of risks ensuing from outsourcing, notably at insurers and pension funds. In addition, the investigation into pension funds' investments will be continued further in 2012. This year, the investigation, which in 2011 was aimed specifically at private equity, hedge funds and innovative investments, will again be of a general nature. One of the aims of the investigation is to ascertain to what extent pension funds have improved their asset management and risk management, following the findings of the earlier investigations into their investments.

4.1 Banks: quality of internal audit function

A well-functioning internal audit function is of crucial significance for controlling the risks to which a bank is exposed. In addition, the internal audit function constitutes an important source of information regarding the risks and the control framework of the supervised institution. In many cases, within Dutch banks, the internal audit function often failed to identify the build-up of risks and the less than adequately functioning control framework in the run-up to the crisis. Moreover, over the past few years, the internal audit function has felt the stress of cost-cutting programmes as a result of the crisis. This has prompted DNB to start an investigation into the quality of the internal audit function. The investigation will deal with a number of issues, including:

- governance and scope: the independence of the internal audit function vis-à-vis the board of management and the supervisory board, as well as its mandate and the scope of its activities;
- the position of the internal audit function vis-à-vis its stakeholders, such as management, the business, control organs, the external auditor and the supervisory authority;
- the internal organisation, management and staffing of the internal audit function itself;

DNB will share its conclusions with the supervisory boards and the boards of management of the institutions concerned, with the external auditors (who often also rely on the work of the internal audit function) and the professional organisation (Netherlands Bankers' Association).

DNB will make sure that any shortcomings identified will be addressed.

4.2 Insurers: risk management in respect of authorisation channel

Insurers may choose to appoint authorised agents accepting risks on their behalf. Developments in this market have prompted DNB to take a closer look at insurers' risk management in respect of authorisations granted. Inadequate risk management regarding the authorisation channel may give rise to reputational damage or even solvency problems at insurers. In 2011, AFM conducted an investigation to gain a better insight into the authorisation channel in general and its control by the insurers in particular. In doing so, AFM concentrated in particular on the control mechanism upon appointment and the subsequent ongoing monitoring. DNB took part in this investigation. However, its results do not provide a sound insight into the risk management by the insurers. In 2012, DNB will build further on this investigation by having the insurers conduct a specific self-assessment and by holding additional discussions. In this respect, DNB will work in close cooperation with AFM.

4.3 Pension funds: control of outsourcing

Most pension funds have outsourced a great deal of activities to a relatively small number of external parties. Examples of outsourced activities are payroll, debt collection, communication, webhosting, pension accounting, custody, (fiduciary) asset management, treasury, the exercise of voting rights, support on behalf of the board and the provision of expertise in various areas. In some cases, the full range of a pension fund's activities has been outsourced to a single pension administrator. At the same time, however, it is the pension fund's board which retains ultimate responsibility. The organisational set-up of pension funds is not invariably in line with a situation of virtually full-scale outsourcing. As a result, pension fund boards may have insufficient certainty about the identification and control of the risks attaching to outsourcing. Hence, the outsourcing risk constitutes one of the major risks facing pension funds. In this light, in 2012 DNB will take a closer look at the outsourcing of activities by pension funds. For this purpose, DNB will request a select number of pension funds to submit relevant documents. In addition, DNB may request pension funds' internal audit departments or comparable functions to prepare a report on this subject, and may also conduct random tests in respect of outsourced activities. In its newsletter, DNB will inform the sector in more detail about the set-up and focus of this supervisory theme as well as about the approach to be used. •

5 Strong management, restrained remuneration

Governance, conduct and culture are of major significance for the soundness and integrity of financial institutions and pension funds. Thus, corporate governance and internal control (controlled conduct of the business) constitute major points of focus of DNB's supervisory effort. Issues that are addressed by DNB in this context include the role and functioning of the key players, to wit the board of management, the supervisory board and the internal control functions (risk management, compliance and audit – also see section 4). In addition, it is important for a financial institution that a business culture marked by integrity is in place.
A culture of integrity is one where everyone's actions can be explained and accounted for. Characteristic of a culture of integrity is that players act in accordance not just with the letter but also with the spirit of the law. Since the financial crisis, governance, conduct and culture have gained an increasingly prominent role in DNB's supervision. The fact is that in the longer run conduct and culture are essential for the financial soundness of financial institutions. DNB has drawn up a policy view on conduct and culture and has conducted examinations in this area. DNB implements the Supervisory Regulation on Sound Remuneration Policies and the Policy Rule on Expertise, takes a closer look than before at the composition and functioning of the supervisory boards of financial institutions and supervises the quality and governance of risk management.

In 2012, too, governance, conduct and culture will again constitute a major supervisory theme. First, DNB will make sure that institutions actually implement their policies on restrained remuneration. Second, DNB will, on the basis of the new Policy Rule on Expertise, assess whether the boards of management have sufficient expertise. Later in the year, when legislation in this area has entered into force, DNB will assess the expertise of supervisory board members. Third, DNB will examine the quality of decision-making and the effectiveness of boards of management and supervisory boards within a large number of institutions.

5.1 Remuneration policy

Restrained remuneration policies, aimed at preventing adverse incentives, is of material significance for controlling financial and reputational risks facing financial institutions. In 2011, the supervision as exercised by DNB sought to ensure that the remuneration policies pursued by the supervised institutions were brought into line with the provisions of the Supervisory Regulation on Sound Remuneration Policies. The adjusted remuneration policies have meanwhile been tested for adequacy.
The large institutions are mostly in compliance, while for

a number of other institutions the investigations will be continued into 2012. In 2012, DNB will make sure that the institutions implement their remuneration policies in actual practice and thus are and remain compliant with the existing regulations. In addition, DNB will continue to discuss this issue at the international level (for instance, within the Financial Stability Board), at the European level (with the European supervisory authorities) as well as at the national level.

5.2 Expertise and capability of boards of management and supervisory boards

On 1 January 2011, the Policy Rule on Expertise entered into force. On the basis of this Rule, the statutory requirement as to the expertise of members of boards of management and the manner in which the supervisory authorities (DNB and AFM) assess this expertise have been elaborated in more detail. Considering the significance of expertise for the soundness of the institutions, it is important that the supervisory authorities should ascertain that the members of the boards of management of Dutch financial institutions have sufficient expertise.

One major lesson that has been drawn from the financial crisis is that the supervision as exercised by the supervisory boards of financial institutions was less than adequate, as a result of insufficient expertise, insufficient independence and insufficient availability of board members. This lesson is currently being worked out in various pieces of legislation. One example is the fit and proper requirement for members of supervisory boards, which will take effect in 2012. In order to permit supervisory board members to be assessed for compliance with this requirement, the general fit and proper requirement as included in the Policy Rule on Expertise will have to be adjusted proportionally to suit the supervisory board members' profile. When assessing a supervisory board member, account will be taken of his/her function, of the environment (nature, size, risk profile and complexity of the financial institution) and of collective aspects (the composition and functioning of the board as a whole), in the same way as is currently being done for members of boards of management.
To this end, in early 2012, DNB will draw up an in-house supervisory manual as well as a uniform assessment procedure and will do so in collaboration with the AFM. Likewise in 2012, as required by the Second Chamber of Parliament, the incumbent members of the supervisory boards of the four largest Dutch banks and the four largest Dutch insurers will be tested against the fit and proper criterion. Where the other incumbent members of the boards of management and the supervisory boards are concerned, DNB may, if there a grounds for doing so

(for instance, based on supervisory observations, signals from the sector, or the functioning of the board as a whole or of an individual member), engage in a re-assessment against the fit and proper criterion.
If it should appear that, in the assessment of supervisory board members, specific additional aspects also need to be considered other than those ensuing from the proportional application of the Policy Rule on Expertise, any such aspects will be included in the course of 2012 in the explanatory notes to the policy rule.

5.3 Management quality and effectiveness

The quality and effectiveness of decision-making within boards of management and supervisory boards is a major determinant of the profitability of a financial institution. By way of its supervision of conduct and culture, DNB seeks to identify and control risks ensuing from conduct and culture at an early stage. These risks may be roughly divided into three categories:

- low decision-making quality, marked by inadequate weighing-up of interests, entanglement of informal and formal processes, inadequate preparation of decisions and insufficient consistency;
- dominant behaviour, detracting from the proper operation of checks and balances and creating a gap between the top and the rest of the organisation;
- insufficient propagation of strategies, causing the organisation to be lacking in direction.

In 2012, DNB will perform investigations into conduct and culture at 18 banks, insurers and pension funds, centring on such issues as well-balanced and consistent decision-making, openness to discussion and role model function as well as group dynamics within the board. •

6 Promoting financial sector safety and integrity

Financial institutions may be abused for illegal activities such as money laundering or financing of terrorism, for instance by clients moving illegally obtained funds through their accounts or conducting transactions with countries or persons subject to international sanctions. If institutions (unintentionally) become involved in such activities, their integrity and, hence, the integrity of the financial sector as a whole may be endangered.
Pursuant to the Act to prevent Money Laundering and Financing of Terrorism and sanctions regulations, financial institutions must report unusual transactions and so-termed hits to the Dutch Financial Intelligence Unit and DNB, respectively. By monitoring clients' transactions and activities, institutions are better able to report such transactions. Supervisory investigations conducted at various institutions over the past few years have shown that these institutions are not always able to identify potential money laundering transactions or transactions aimed at financing terrorism. Questions from institutions or delays in the provision of information by institutions also show that not all of them always have the proper processes and procedures in place to be able to comply with the integrity legislation. In addition, in its evaluation report dealing with the Netherlands, the Financial Action Task Force noted that certain sectors, such as insurers, payment institutions and trust offices should focus to a greater extent on monitoring compliance with sanctions regulations. Accordingly, this will constitute a primary objective of DNB's integrity supervision in 2012.

6.1 Banks

In 2010, DNB assessed the customer due diligence in respect of the private banking operations of twelve banks. Four of them proved insufficiently compliant and shortcomings were in evidence at the remaining eight.
In addition, considerable changes have taken place to the warning list of the Financial Action Task Force. Business relationships with residents of countries featuring on the warning list or transactions to or from these countries involve an enhanced risk of money laundering and financing of terrorism. In this light, in 2012 DNB will conduct investigations at banks which engage in large numbers of transactions with such countries to assess compliance with the Act to prevent Money Laundering and Financing of Terrorism and with sanctions regulations and to assess the control of integrity risks in respect of high-risk activities and clients. DNB will request and analyse information from this sample of banks and will conduct on-site examinations. The findings, possibly including good practices, will be shared with the sector.

6.2 Life insurers

Earlier investigations by DNB have shown that at life insurers, too, insight into the risks of money laundering is generally insufficient. Also, in its evaluation report, the Financial Action Task Force noted that, where life insurers are concerned, DNB should focus to a greater extent on supervising compliance with the Act to prevent Money Laundering and Financing of Terrorism and with sanctions regulations. In 2012, DNB will conduct investigations at a select group of life insurers to assess the adequacy of their monitoring of clients and activities and of the control measures taken to that end. As in the case of the banks, these investigations will take the form of regular supervisory examinations, consisting of requesting and analysing information and on-site examinations. Here, too, the findings, possibly including good practices, will be shared with the sector.

6.3 Money transfer offices

Regrettably, payment institutions in the Netherlands which engage in money transfers are often abused for purposes of money laundering. Since early 2011, DNB requests information on a quarterly basis on all transactions conducted by all locations in the Netherlands which engage in money transfers. DNB uses this information to prepare market-wide network analyses to gain an insight into the activities in this market. By analysing the transactions, DNB obtains an impression of the most active institutions. Subsequently, these institutions are urged to take adequate measures to prevent money laundering. In 2011, this manner of exercising supervision yielded satisfactory results. In a few cases, money transfer office locations were shut down on indications they were abused for money laundering. The system of transaction analyses also has a preventive effect now that the institutions must submit all their transaction data to DNB. In 2012, the project will be continued in a similar form, with DNB focusing to a greater extent on the internal procedures at payment institutions. It is the payment institutions themselves which are responsible for their own transactions and, consequently, it is up to them to take appropriate measures to prevent any involvement in money laundering.

6.4 Trust offices

In 2010 and 2011, DNB conducted theme-driven examinations at trust offices centring on operational object companies. In these examinations, DNB pays particular attention to the origin and intended use of the object company's assets and to the degree to which the trust offices adequately control the attendant integrity risks. The examinations showed that, notably for object companies which provide consultancy services, the risks are substantial and that their control by the trust offices is often less than sufficient. Moreover, the Financial Action Task Force refers to the abuse of consultancy entities for channelling away criminally obtained moneys or laundering such moneys.

Hence, in its 2012 examinations, DNB will focus mainly on object companies providing consultancy services. The objective of the examinations is to counter the abuse of trust offices by such object companies. Considering their gatekeeper role, trust offices must be aware of the recipients of the flows of funds and must analyse the related integrity risks. Trust offices which insufficiently recognise the risks to which they are exposed in their dealings with such companies, for instance because transaction monitoring is inadequate, will be called to account by DNB. In the event of shortcomings in risk management being found, DNB will take corrective action. As a last resort, the licence may be revoked.

6.5 Cybercrime

Cybercrime increasingly poses a threat to the soundness and integrity of financial institutions. The potentially harmful effects of cybercrime are diversified and substantial:

- dislocation of the financial core infrastructure;
- loss or alienation of large amounts of privacy-sensitive client data with an enhanced risk of identity fraud;
- loss of public confidence in internet payments;
- losses at financial institutions.

DNB has found that the security level at financial institutions aimed at countering these threats is too low. This is in part caused by cost-cutting programmes undertaken in response to disappointing financial results but also by the emergence of new media which feature lower security levels. DNB expects all institutions to make an additional effort to raise and maintain the quality of their data security.

For this purpose, in 2010 and 2011, DNB developed a self-assessment relating to security management and monitoring and launched it at several financial institutions. On the basis of the results of this self-assessment, concrete arrangements have been made with the institutions concerned to further improve data security. In 2012, the number of institutions involved will be increased further, and initial follow-up measurements will be conducted to assess whether the institutions have actually complied with the arrangements. •

7 Improved supervision through better data

The reporting forms submitted by the institutions constitute the foundation for DNB's supervision. The submission of correct, reliable and timely returns is essential to enable DNB to come to an overall perception of an institution's risk profile.

7.1 Banks

Banks must report on a quarterly basis on the results of their business and on their solvency and liquidity position (using the so-termed FINREP, COREP and liquidity reporting systems). When using these returns in its supervision, DNB relies on the framework of controls surrounding the processes by which these prudential returns are completed. This framework consists of an adequate system of administrative organisation and internal control within the reporting institutions themselves and an annual external audit of the FINREP and COREP returns. Last year, DNB started an initial pilot examination. The examination showed that, at a number of supervised institutions, the prudential returns were marked by several deficiencies, in some cases causing unduly favourable and, hence, incorrect capital and liquidity ratios to be reported.

In 2012, DNB intends to gain more insight into the processes surrounding the completion of the prudential returns, the relevant control measures and the roles played by the internal and the external auditor. For this purpose, DNB will hold discussions with the institutions themselves and with their internal and external auditors. The completion process for the relevant returns will be assessed on the basis of file reviews and the results of specific audit samples. In addition, DNB itself will also perform a number of sample checks in respect of relevant reported items. Where necessary, DNB will urge institutions to improve their internal processes and, if need be, impose sanctions. Furthermore, DNB will assess whether it is desirable for the audit scope to be increased and for the liquidity returns to be covered by the audit as well.

7.2 Life insurers

Likewise, DNB will focus on the quality of the figures reported by insurers, notably where their technical reserves are concerned. This represents a sequel to last year's examination. The adequacy of the technical reserves decides whether an insurer will be able to meet its anticipated future liabilities. Insurers must perform adequacy assessments on at least an annual basis. DNB appraises these assessments and discusses its findings with each insurer. In the assessment of the returns for the financial year 2009, some points came up which required further attention. Hence, DNB has examined and compared the returns dealing with the adequacy tests for the financial year 2010. In those cases where the underlying data were not yet up to standard, DNB has asked the relevant insurers to effect improvements. In order to provide an aid, DNB has combined insurers' best practices in respect of implementation and reporting in a good practice. In 2012, DNB will assess whether the insurers have made the necessary improvements as regards implementation and reporting. This applies in particular to the valuation of options and guarantees and to the sensitivity analyses. A sound insight into liabilities and sensitivities is essential for the sector's future, supports the insurers in preparing for the new Solvency II supervisory framework and may contribute to a recovery of public confidence. •

8 Conclusion

The 2012 supervisory priorities as set out in this brochure were put together in December 2011. However, the financial sector continues to be characterised by considerable uncertainties. Especially in times like these, unforeseen developments cannot be ruled out. If the need arises, DNB will introduce new accents in its programme in the course of 2012.

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