Supervisory Strategy 2014-2018

Strong player in the SSM
Sharp analysis
Alertness to integrity issues
Transparency where possible
1 Introduction

What are the major challenges faced by the financial sector at present? What must be done in the years ahead to meet these challenges successfully? How can we contribute as a supervisor and what can other stakeholders do?

These are the questions that DNB wants to answer in this Supervisory Strategy. DNB's Supervisory Strategy thus serves both an internal and an external purpose. The internal goal is to define a strategy for DNB as a supervisor for the years ahead and to implement its mission of ensuring that financial institutions are sound and uphold high ethical standards. Our external goal is to inform supervised institutions, politicians and the public on our plans for the sector and our supervision, the opportunities we see and the constraints we face, and how we view the roles of other stakeholders.

Our new strategy builds on the tightening of supervisory practice pursued in recent years under the DNB Supervisory Strategy 2010–2014 and the 2010 Action plan for a change in the conduct of supervision. The lessons learned from the crisis, as set out in these documents, still apply in full. The present strategy also takes account of experience gained since and tries to learn from things that we would have preferred not to see happen, for example the nationalisation of SNS Bank and the Libor affair.

We believe also that we can improve our supervision by learning from the experiences of other supervisors. To this end, we have held talks with a large number of supervisors both in the Netherlands and abroad.

These talks were an important source of inspiration in developing this strategy.

This strategy is intended to be practical and concrete. This means setting clear goals and indicating how supervision can help towards achieving them. For this purpose, we formulate action points for improving supervision. This strategy is therefore not an end goal but rather a starting point: in order to truly improve supervision further, we are to implement these action points.

This strategy also aims to hold other stakeholders, particularly supervised institutions, to their own responsibilities. They too are expected to make a contribution towards achieving our objectives.

This strategy encompasses both prudential and integrity supervision. In addition, DNB is responsible for oversight aimed at reliable and efficient payment and securities systems. Banks, payment institutions and electronic money institutions play an important role in this regard, as do market infrastructure organisations such as settlement institutions, central counterparties and central securities depositories.

This strategy document is organised as follows. Chapter 2 explains what we regard as the main challenges facing the financial sector. These challenges will have to be addressed if we are to implement our supervision mission successfully, i.e. ensuring safe and sound institutions that fulfil their obligations and commitments.

We will explain our goal in respect of each challenge. Obviously, we realise that much of what we wish to achieve is beyond our direct control as a supervisor.
But goals are important for any organisation in order to steer its actions, and we consider it important to let our external stakeholders know where we stand as a supervisor in matters that will define the future of the sector.

Chapter 3 sets out what we can do in order to better implement our supervisory mission and work towards achieving our goals. We will highlight four main priorities: the introduction of the Single Supervisory Mechanism (SSM), our approach to supervision, integrity supervision and transparency. By far the most important new development is the introduction of European banking supervision, the Single Supervisory Mechanism, later this year. This will have major consequences for the way banking supervision is organised in the Netherlands. Second, in the years ahead DNB wishes to make further improvements to the supervision approach described above.

We believe that the SSM will support us in this respect. A third priority is supervision of the integrity of the financial sector. In view of what has happened in recent years, for example the events leading to the nationalisation of SNS Bank and the Libor affair, there is cause for reviewing integrity supervision. Fourth, DNB wants to explore new ways of providing greater transparency about its supervisory duties. Much of what we do as a prudential supervisor necessarily takes place behind the scenes. As a result, we are not always able to show what we do and what effect we achieve or wish to achieve. By making the best possible use of the existing opportunities for transparency, we can meet a social need, increase support for supervision and improve its effectiveness.

Supervision does not operate in a vacuum: external events have a major effect on whether or not we achieve our objectives. Chapter 4 therefore discusses what other stakeholders can do. Where the government is concerned this primarily relates to legislation and regulations (both prudential and non-prudential) and policies affecting the structure of the financial sector. In addition, we wish to hold supervised institutions to their responsibility to help meet the challenges that the sector faces.
2 Challenges for the Dutch financial sector

Looking at the Dutch financial sector at the start of 2014, we see that it is still in the process of recovering from the financial crisis. There is not much time to catch our breath, however: the prolonged recession has depressed earnings and made recovery more difficult. At the same time, institutions should be preparing for the wave of stricter regulations heading their way as a result of the crisis. Some parts of the financial sector are also struggling with overcapacity and unfavourable cost dynamics. Perhaps the most important factor, however, is the loss of public trust, which is a common thread running through the financial sector as a whole. The crisis has stirred up feelings of dissatisfaction about developments in the financial sector. This public dissatisfaction is harmful to the stability of the financial system. The financial sector is therefore facing the challenge of regaining public trust. The emphasis often differs slightly from sector to sector.

2.1 Banks

Challenge 1: regaining trust
Although banks have undeniably taken measures to improve the situation, there is still a great deal of distrust. To recapture trust, banks must continue working on an ethical culture, sound remuneration policies and sustainable business models. What is more, in a climate of distrust no news is bad news. This is why banks will have to be more transparent about their products and financial position making it easier for consumers and investors to assess risks.

Where do we want to be in four years’ time?
Banks offer transparent products and avoid needless complexity. Banks themselves have also become less complex and can thus be governed more effectively. Banks have improved their risk management and compliance functions. Banks publish clear and comparable balance sheet data and provide consumers and investors with more information about their financial position. Bank directors promote a culture in which risks and customers’ interests are given sufficient priority, and harmful and illegal activities are not tolerated. This should be reflected, for example, in a decline in the number of integrity incidents. Trust indicators are showing an upward trend.

Challenge 2: further strengthening financial resilience
Although Dutch banks have managed to strengthen their capital positions in recent years, they must restore their buffers even further in order to comply with the Basel III/CRD IV/CRR requirements and be able to support the economic recovery by means of sound credit growth.
In the short term, banks will be largely dependent on profit retention to strengthen their buffers as required. Nonetheless, amid the still difficult economic and financial circumstances, it is important for banks to maintain the course they have set, in keeping with their Basel III migration plans. As matters stand at present, this means that there will be little, if any, scope for dividend payments. New share issues may also help to strengthen capital in the years ahead.

In addition, the Dutch banking sector continues to rely heavily on market funding, despite the gradual decrease since 2008. This is reflected in the Dutch banking sector’s loan-to-deposit ratio, which is high by European standards. The resulting refinancing risk makes the banks vulnerable to any deterioration in financial markets conditions. It is important to reduce this reliance still further, for instance by improving the balance between mortgage portfolios and the deposit base. In addition, refinancing risks can be further reduced by extending the average maturity of market funding.

Where do we want to be in four years’ time?
The transition to Basel III has been completed: banks have greatly strengthened their capital positions in keeping with the new stricter capital requirements. As a result, they have become less vulnerable to unexpected losses and are able to meet the increased demand for loans, which is reflected in moderate but steady lending growth. Reliance on market funding has substantially decreased.

**Challenge 3: less complexity, better resolution**
The major banks in the Netherlands are too big to fail: in other words, they play such a pivotal role that their insolvency would disrupt the financial system and the economy to an unacceptable degree. Without effective crisis management tools this creates risks for the government, as providing state aid would weigh heavily on public finances. An effective European intervention mechanism, including recovery and resolution plans and a bail-in regime (with losses borne primarily by creditors) is needed to facilitate swift action, continuation of critical functions and containment of risks to governments and financial stability. This would also help to reduce the complexity of banks. The recent European agreement on a framework directive for bank recovery and resolution (BRRD) and the proposals of the European Commission for a European resolution mechanism represent a major step forward in this area.

Where do we want to be in four years’ time?
A uniform European policy on recovery and resolution, prepared by a European Resolution Council, is in place. This is supported by a range of powerful intervention tools and, if necessary, funded by a privately financed European resolution fund. This has greatly reduced the likelihood of a systemic crisis. The recovery and resolution plans have helped to bring about structural changes that make it easier to wind up banks. Since these changes also mean that banks have become less complex, they are easier to govern and cause fewer prudential risks. Bail-in is a realistic option and is reflected in pricing on the financial markets. However, thanks to the consistency and predictability of the bail-in
policy, upward pressure on funding costs for banks has remained limited.

2.2 Insurers

Challenge 1: regaining trust
Trust is an essential commodity for insurers. This is especially true of life insurers, as they sell products that have a distant maturity date and the prospect of pay-out is preceded by many years of premium payments. Trust has waned as a consequence of the crisis and the failure of the industry to take proper account of customers’ interests when selling unit-linked policies. The lack of trust poses an immediate threat to the sector’s viability. With this in mind, recovery deserves maximum priority. Insurers will therefore have to adjust their business models to take more account of customers’ interests in the long as well as the short term, by being more transparent about their products and by avoiding undue complexity. They will also have to make their business models less vulnerable to changes in tax legislation. This will require the sector to demonstrate leadership and capacity for innovation.

Where do we want to be in four years’ time?
Insurers have products that are simple and transparent and meet customers’ needs. The Netherlands Authority for the Financial Markets (AFM) assesses these products positively. The priority given by insurers to customers’ interests gradually pays off as trust indicators start to move upwards.

Challenge 2: consolidation in a shrinking market
Premium income of life insurers is under severe pressure: sales of individual life insurance products are falling and seem to have embarked on a structurally downward trend. In view of the high overhead expenses that life insurers have (staff and ICT systems), economies of scale are proving counter-productive in these circumstances. This poses an immediate threat to the sector’s profitability. Insurers can offset the loss of sales on individual life policies by tapping into adjacent markets, for example pensions, banking products, and foreign insurance markets. However, this is not easy and requires prudence and focus. Cost reductions are therefore unavoidable. Although there is considerable potential for cost reductions through greater efficiency, particularly in the area of ICT systems, it is not easy in practice to harness this potential. It follows that economies of scale achieved by consolidation are an important alternative. Portfolio transfer to specialist run-off parties can also help to reduce costs. However, large mergers and acquisitions have as yet failed to materialise. One of the reasons for this is the continuing uncertainty about possible future claims related to unit-linked policies sold in the past. The institutions concerned must therefore make every effort to galvanise vulnerable customers into action thereby reducing the uncertainty about this claim risk.

Where do we want to be in four years’ time?
The insurance sector has made considerable progress in achieving consolidation and enhancing efficiency. Closed portfolios have been transferred to specialist parties. Insurers have also managed to modernise and streamline their ICT systems. As a result, cost levels have fallen significantly and profitability has improved.
**Challenge 3: stronger buffers and more professional risk management**

There is a pressing need for a risk-based supervision framework to promote stronger buffers and better risk management. Solvency I is no longer fit for purpose, and Solvency II is expected to take effect in 2016. This is why it is important for insurers to continue their preparations.

*Where do we want to be in four years’ time?*

Insurers and supervisors operate within a risk-based supervision framework (Solvency II). This framework has led to strengthening of capital buffers and significant progress in putting risk management on a more professional footing. Insurers only provide investment return guarantees in line with market rates and do not offer products with a negative value. By carrying out their Own Risk and Solvency Assessment (ORSA), insurers are constantly aware of the risks and the resulting capital requirement, and incorporate the outcome in their decisions.

### 2.3 Pension funds

**Challenge 1: regaining trust**

Due to economic and demographic trends, it has not always been possible to live up to expectations raised in the past with regard to pensions. This has led to a loss of confidence in the present pension system and diminishing support for the ensuing redistribution.

*Where do we want to be in four years’ time?*

Owing to adequate valuation of pension entitlements and clear communication, pension fund members have a clear understanding of the costs, expectations and risks in respect of their future pension benefits. Pension funds no longer promise more than they can deliver. This helps to regain trust in the pension system.

**Challenge 2: improvements in professionalism and cost efficiency**

Where participation in a second-pillar pension plan is mandatory, pension fund members must be able to rely on the scheme being operated in a cost-efficient manner. This applies both to fund administration and asset management costs. The present differences in levels of costs are sometimes very pronounced, so much so that they cannot be explained. The professionalism and expertise of pension fund governing boards is also open to improvement, particularly where asset and risk management are concerned. Economic, demographic and social developments and the instability in the financial markets are putting pension fund governing boards under increasing pressure. At present, the quality of pension fund management is not always adequate. Consolidation could help in both areas.

*Where do we want to be in four years’ time?*

Greater transparency about the costs of pension build-up has made fund administration more cost-efficient. Consolidation has continued and produced further economies of scale and cost savings. Costs have also been saved as a result of less complex pension schemes. Pension funds have used the opportunities provided by the Pension Fund Governance Reinforcement Act (*Wet versterking bestuur pensioenfondsen*) to achieve a more robust and effective organisational structure.
The quality of risk management and the expertise of pension fund governing boards match the increased complexity of investments.

**Challenge 3: a future-proof pension system**
The introduction of a new Financial Assessment Framework *(Financieel Toetsingskader - FTK)* can make an important contribution to the financial sustainability of the Dutch pension system. Moreover, the pension system could be reformed to bring it more into line with the societal and economic changes of the past decade. For example, we may wonder whether average contributions are still in line with the present labour market relations, including such developments as greater labour mobility and the increased number of self-employed people. There are also important issues concerning the impact of the substantial volume of pension assets on the resilience of the Dutch economy, the organisation of pension funds along the lines of businesses/industries, and inter-generational solidarity.

**Where do we want to be in four years’ time?**
All pension funds have a financial set-up in keeping with the goals laid down in the pension scheme, taking account of the risk profile envisaged by the fund members and the new assessment framework *(FTK)*. DNB will review this in the context of its implementation. In addition, steps are taken, in consultation with all stakeholders concerned, to achieve a future-proof pension system and assessment framework that also foster financial and macroeconomic stability.

**2.4 Other institutions**

**2.4.1 Investment firms and investment funds**
*Challenge: financial resilience and continuity of service*
Investment firms and investment funds are financial service providers that operate under an authorisation granted by the AFM. They focus mainly on providing asset management services. For the most part, prudential supervision of these market participants involves ensuring their financial soundness as a way of guaranteeing the continuity of their services. Investment firms will have to redefine their position in the market as many of them will be required to modify their fee structure from 2014 onwards, due to the ban on commission. Investment funds managing the assets of professional market participants will be subjected to supervision for the first time in 2014. One of the main objectives of this is to obtain information about potential systemic risks resulting from the use of leverage by these funds.

**Where do we want to be in four years’ time?**
Investment firms and investment funds are safe and sound financial institutions that fulfil their commitments and obligations. Moreover, information exists at national and European level about the extent to which leverage within investment funds contributes to systemic risks and, where necessary, action is taken to deal with this. Investment firms and investment funds are ready for the future; this can be achieved together with the AFM.
2.4.2 Premium pension institutions (PPIs)

Challenge: PPIs to provide adequate safeguards for the interests of pension scheme members

The premium pension institution (PPI) was introduced as a new type of pension provider in 2011. A PPI may also be active abroad, but may only operate defined contribution schemes (i.e. schemes in which the contribution but not the amount of the ultimate pension is fixed). PPIs are often part of a larger group, usually including a bank, insurer or investment firm. Generally, much of the work is outsourced to other group entities. It is important that PPIs do not function in the market solely as a product, but rather act as independent parties that take responsibility in the interest of their customers for all activities, even if they have been outsourced to other group entities.

Where do we want to be in four years’ time?
PPIs provide a sound and reliable alternative to the present pension providers and are ready for the future. PPIs comply with their duty of ensuring that pension schemes are operated cost-efficiently and transparently, and communicate properly with their members.

2.4.3 Trust offices

Challenge: internalised ethical culture

Owing to its tax-friendly climate for businesses, the Netherlands has a substantial trust sector. This entails a relatively large integrity risk and hence also a reputational risk for the Dutch financial sector. Not all trust offices manage their integrity risks adequately, the main reason being that their corporate culture is insufficiently ethical. They comply with the letter rather than the spirit of the law and tend to mitigate their risks only after DNB has emphatically drawn their attention to them.

Where do we want to be in four years’ time?
Trust offices have effective measures in place for managing their integrity risks. The sector fulfils its duty of identifying and mitigating risks and has ensured that the importance of integrity is firmly embedded in their corporate culture. This is strictly supervised by DNB by means of thematic and individual examinations conducted in cooperation with its partners in the Financial Expertise Centre (FEC).

2.4.4 Payment institutions and electronic money institutions

Challenge: responsible innovation in a European framework

The number of Dutch payment institutions and electronic money institutions keeps on growing. Newcomers to the sector are often new enterprises that develop and offer innovative, cross-border payment methods. The number of payment institutions operating in the Netherlands with a European passport is also on the rise. In the years ahead, new business models will have to prove themselves on a properly functioning European playing field. Finally, the sector will have to demonstrate that it is taking adequate steps to mitigate the inherently high integrity risk.

Where do we want to be in four years’ time?
Payment and electronic money institutions have developed into a mature sector, with innovative, prudent, ethical, and readily accessible being the operative words. For an efficient and harmonised
approach to supervision of this sector, DNB will cooperate more closely with European supervisors. DNB supervises these institutions by means of thematic examinations based largely on sharp data analyses and signals received.
3 What can supervision contribute?

Achieving these goals requires a joint effort on the part of all stakeholders concerned, each acting in accordance with its own responsibilities. This chapter deals with the contribution that the supervisor can make.

3.1 Supervision: substantially strengthened, but still scope for improvement

In response to the financial crisis, the regulations that financial institutions must observe have become much stricter in recent years. Many of the new regulations originated in the EU, but some of them are national in nature. For example, the Basel III rules for banks were introduced this year at the European level in the Capital Requirements Directive IV and are currently being phased in. Under Solvency II, insurers will have to comply with much tougher requirements on equity and risk management. And Dutch pension funds will have to make changes as a result of a new financial assessment framework. The new Intervention Act (Interventiewet) will further increase the scope for intervening in failing institutions and for minimising the costs to the taxpayer. The European Directive on the recovery and resolution of banks will provide a further boost for the development of these tools.

DNB’s prudential supervision has also been considerably strengthened in recent years. This was prompted by the policy set out in DNB’s Supervisory Strategy 2010-2014 and the 2010 Action plan for a change in the conduct of supervision.

- Supervision has become more theme-oriented. This means that we more often assess and address prudential risks on a sector-wide basis rather than by just examining individual institutions. DNB now allocates about 25% of its supervision resources to thematic supervision. Institutions and other stakeholders are informed annually of the supervisory themes by means of a brochure.
The link between macroprudential analysis and microprudential supervision has been improved. DNB keeps a macro register listing the principal macroprudential risks that supervisors must take into account when assessing the risk profile of their institution. Risks affecting the financial system as a whole now form important input when determining the risk profile of individual institutions and the action to be taken in response.

Supervision has become more forward-looking. Institutions’ business models and their corporate culture and decision-making processes (which are factors that can have a major bearing on long-term soundness) now form an integral part of supervision.

Supervision has been intensified and become more intrusive and decisive. And there is a greater willingness to intervene. A recent survey shows that this is also the perception of the financial sector itself.

The introduction of a new system of identification and risk mitigation (Focus) has created greater discipline and consistency in the supervision process for banks, insurers and pension funds alike.

The supervisory organisation has been strengthened in a number of respects. First, we have carried out a thorough restructuring. The role of the specialist expertise centres has been strengthened, and intervention and enforcement have been assigned a separate and hence stronger position within the organisation. This is also true of the internal quality control of supervision. Second, staff resources were increased by 2.9% per year between 2006 and 2013. Third, DNB has managed to raise the level of specialist expertise substantially by means of internal training and external recruitment.

We are now more transparent about our supervision and more aware of our duty to account for our actions. Greater scope for this has also been provided by new legislation designed to limit our liability and allow the Netherlands Court of Audit to inspect information classified as confidential for supervision purposes.

DNB leads the way in using effect measurement as a tool to manage its own organisation and to explain to the outside world what we do. Measuring results is a standard part of our supervision examinations. Where possible, we are increasingly making the results of examinations public through our annual accountability report and interim publications.

Prudential supervision is never ‘finished’. In the above areas, we intend to continue what we have set in motion. But even as we do so, things are changing around us. Given the exceptionally dynamic nature and innovative capacity of the financial sector, supervision is almost automatically bound to lag behind developments in the sector to some degree: the challenge here is to minimise the distance by which we lag behind. This is why an effective supervisor should be prepared to learn quickly from past experience, respond alertly to new developments and, wherever possible, anticipate future trends. We believe that four areas of supervision will require more than average attention in the period ahead.
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3.2 Strong player in the SSM

The European Single Supervisory Mechanism (SSM), under the supervision of the European Central Bank (ECB), will become operative in November 2014. As a partner in the SSM, DNB is committed to achieving strong and effective European banking supervision. As a member of the SSM’s Supervisory Board, DNB will be one of the policy-making parties. Moreover, as DNB is jointly responsible for supervising significant banks and also supervises less significant banks, it will continue to carry out the majority of the supervision of Dutch banks. To ensure financial stability in Europe and achieve our supervision goals, it is of the utmost importance for European banking supervision to be effective, practicable and enforceable. This is the basic concept underlying all our positions and objectives within the SSM. Below are the seven main objectives.

- Close alignment between the SSM and the European Single Resolution Mechanism (SRM) It is important for the two main pillars of the banking union, i.e. European supervision and the European resolution mechanism, to be launched simultaneously where possible. This is why a new European body is needed to decide on the resolution of problem banks and on resolution funding. It will use the tools introduced in the Bank Recovery and Resolution Directive (BRRD) and will be supported by a European resolution fund, funded by contributions from the sector itself, and a public financial backstop. Although the basic idea behind the BRRD is that creditors should contribute to the

- Strong player in the SSM It is of great importance for the SSM to be effective and DNB is fully committed to ensuring its effectiveness. At the same time, we wish to make optimum use of the SSM in order to strengthen our own approach to supervision and thus ensure that DNB remains an effective supervisor, also as part of the SSM.

- Sharp analysis We will strengthen our information base by carrying out more deep-delving supervisory examinations of institutions and by remaining alert to any underlying patterns (‘connecting the dots’). We will intervene in time, even if a positive outcome is not guaranteed.

- Alert to integrity issues We will formulate a supervision-wide strategy for integrity supervision, creating clarity about priorities and the role of each of those involved, and will allocate more resources for this purpose. Account supervisors are becoming more alert to integrity signals and are supported by experts. We will share signals on a regular basis, invest in trend analysis and make greater use of external sources.

- Transparency where possible We will publish more about financial institutions and our supervision. We will work more consciously on providing a clear and consistent account of supervision to our stakeholders. We will start a dialogue with external stakeholders and measure ourselves by reference to national and international peer reviews such as the IMF’s Financial Sector Assessment Programme.

These four points are briefly explained below.
resolution of a bank, with the resolution fund acting as a backstop, the use of public funds can never be entirely ruled out. To end the negative interaction between banks and governments, a European risk-sharing system is necessary.

Thorough review of banks’ balance sheets. Before banks are placed under European supervision, their balance sheets must be thoroughly reviewed, followed where necessary by recapitalisation. This is important for two reasons. First, it is intended to prevent situations in which European governments have to pay the price for legacies from the past and the reputation of the new European supervisor is immediately put to the test. Second, the review of balance sheets is important in order to make a clean break with the past of the banking sector in Europe, thereby restoring trust and enabling the sector to vigorously resume its lending role.

Effective supervision teams. Although the SSM is admittedly a system of supervisors, it must operate as a single organisation if it is to be effective. It is therefore essential to have properly functioning supervision teams with strong and clear management and short reporting lines to the ECB’s senior management and to the Supervisory Board.

Dissemination of valuable elements of DNB supervision within the SSM. It is important for the ECB’s supervision to be sufficiently forward-looking. This requires supervision not only to examine financial indicators but to also pay attention to institutions’ business models and culture. DNB will press for this within the SSM.

Macro-micro linkage to be firmly embedded in the SSM. In recent years, DNB has strengthened the macro-micro linkage and put it on a formal footing. It is important to achieve this at a European level as well. Macroprudential risks must be taken into account in assessing the risk profile of individual institutions and, if necessary, be translated into supervisory measures. Through the macro-register, DNB will continue monitoring macroprudential risks in the SSM. These will form the input for the ECB’s macroprudential analysis and the use of macroprudential tools. In addition, DNB will continue performing stress tests of both large and small banks.

Successful horizontal supervisory functions for both specific areas of expertise and thematic supervision. The assignment of specific expertise to horizontal supervisory functions promotes efficient pooling of scarce expertise across the entire range of supervision and promotes a cross-institutional perspective. DNB is therefore in favour of applying this organisational model within the SSM as well.

Adequate supervision of small banks. DNB will ensure that its supervision of less significant banks remains of a high standard, in keeping with the methods applied by the SSM and retaining the strengths of DNB’s supervision.

Besides implementing and helping to determine policy on banking supervision, DNB will continue to have duties and responsibilities that fall outside the SSM’s mandate. DNB needs to have sufficient scope to adequately discharge these responsibilities even after the advent of the SSM. An important example of this is macroprudential policy. DNB will continue to contribute to financial stability in the Netherlands. Its financial stability mandate is strengthened by
the explicit reference to it in the Financial Supervision Act (Wet financieel toezicht or Wft) and the Bank Act (Bankwet) as of 1 January 2014, and is not confined to the banking sector but extends across the entire financial sector. When discharging these responsibilities DNB can make use of both the macro- micro link, through the macro register referred to previously, and new macroprudential tools. Examples include the designation of countercyclical capital buffers, the imposition of requirements on systemically important institutions and the adjustment of risk weights for specific asset classes (property).

3.3 Sharp analysis

DNB’s Supervisory Strategy 2010-2014 and DNB’s Action plan for a change in the conduct of supervision have brought about a major change in how DNB supervises financial institutions. The main changes have already been described in Section 3.1. We want to be a supervisor that learns from experience and from the experience of its fellow supervisors. That is why we are taking advantage of this strategy to consider afresh how supervision can be improved. We see opportunities for improvement in four areas.

A. We will improve our information base, in particular our information about supervised institutions

There will be a new system for accessing, analysing and reporting supervision data. This will make it easier to access standard analyses and reports, provide faster and better information about major changes in the financial data of an institution and create time for other important matters (see below). We will also be less reliant on the analyses carried out by institutions themselves and will perform more deep-delve examinations, for instance into property risks. It should be noted that this will also be driven by the introduction of the SSM. In addition, we wish to broaden our information base by mobilising external know-how, and we wish to engage in a closer dialogue with the sector itself about what it considers to be the principal risks and how it views the supervision of these risks. This does of course not alter the fact that the supervisor has the final say.

B. We will improve the quality of our risk analysis

A sharp analysis of the risks that financial institutions are exposed to and their underlying causes is essential to influence the conduct of institutions effectively. In 2012, we implemented a new risk analysis and evaluation method. This has improved consistency and discipline in the supervision process, thereby greatly reducing the likelihood that risks will be overlooked. The method also sheds a critical light on the process from another angle as supervisors are required to defend their analysis of the risks that their institutions are exposed to in challenge sessions. In the period ahead, we wish to upgrade this method by improving the standard of our analyses and attaching greater weight to the independent views of our supervisors. We will also be alert to the need to integrate macro-prudential risks into micro-prudential risk assessments by means of effective use of the macroregister.

C. We want to influence the conduct of institutions more effectively

If conduct is to be influenced effectively, the quality of the underlying analysis is crucial, as is having a
clear idea of the desired result. Transparency can be an effective means of influencing the conduct of institutions. To this end, we intend to give greater priority internally to training and to exchanging information about the efficacy of the various tools for influencing conduct. A conscious choice of tools and impact measurement will be fully integrated into regular supervision.

D. Expertise and competences are to be strengthened

Sometimes we lack the specialist knowledge and competences needed in order to alter the conduct of supervised institutions effectively and promptly. Our recruitment and training policy is designed to fill any gaps in this respect.

3.4 Alertness to integrity issues

Besides financial soundness, integrity is a precondition for trust in the financial sector. Integrity incidents are often symptomatic of a worrying attitude to risk and tend to harm trust. They can also have financial consequences in terms of fines, claims for damages and dissatisfied customers. In addition to its prudential supervision function, DNB therefore also supervises the integrity of financial institutions.

Integrity supervision is regulated by law in the Financial Supervision Act (Wet financieel toezicht - Wft), the Money Laundering and Terrorist Financing (Prevention) Act (Wet ter voorkoming van witwassen - Wwft) and the Sanctions Act (Sanctiewet).

In view of recent developments, such as the events leading to the nationalisation of SNS Bank and the Libor affair, integrity supervision must be intensified. This has prompted DNB to initiate several improvements, some of which have already been implemented.

1. We have formulated a transparent strategy, which defines clear goals and describes which instruments and capacity are necessary and what each person’s role is.

2. Besides the usual emphasis on compliance, risk management and the integrity of managers and directors, greater priority will be given to detecting integrity breaches. That is not to say that DNB is capable of identifying all integrity breaches. This is first and foremost a matter for the institutions themselves, but it does mean that we are becoming more alert to such issues in our regular supervision work.

3. Risk assessment and exchange of information within DNB are being improved to the effect that the existing information can be used more easily to recognise a pattern of conduct. For this purpose, we are making use of the experience gained by other organisations, including the Authority for the Financial Markets.

4. When DNB identifies integrity breaches, it will coordinate its response with its partners in the Financial Expertise Centre (FEC). Priority will be given to those incidents that carry the highest risk and may cause the greatest harm. If necessary, extra capacity will be freed up by flexible deployment of the existing supervisory capacity.
3.5 Transparency where possible

DNB has a duty of confidentiality in respect of all information obtained from supervised institutions. This is provided for in the Financial Supervision Act and the Pensions Act (Pensioenwet), which in turn build on EU legislation. Nonetheless, DNB is endeavouring, within the scope of its powers, to provide increased transparency about its supervision. There are two reasons for doing so. The supervisor has a duty to explain to both politicians and the general public how it performs the duties entrusted to it. By being clear about what we wish to achieve by which means, and by accounting for the results achieved, we can provide the outside world with an insight into our effectiveness. Indeed, this is what society and the political world expect from us more and more. In addition, DNB views transparency not only as a necessity but also very much as a means of increasing its effectiveness as a supervisor.

DNB publishes on its website findings from the thematic examinations within a sector or group of institutions. In addition, our annual Accountability Report gives an annual sector-by-sector overview of our principal supervisory examinations and their outcome. But more openness is still possible and desirable. DNB is actively looking for new ways of publishing more about supervision and about financial institutions.

We intend to publish a uniform set of key financial data from supervisory reports on individual banks and pension funds. Where necessary, we will promote amendments to the law in order to permit publication. DNB already publishes on its website the public particulars of insurers’ annual statements.

Obviously, we are also looking to see what more we can do within the existing statutory framework. We are exploring the following options.

- We may consider publishing our views or concerns about a supervision problem on the basis of existing information made public by the institution itself.
- It may also be possible in specific cases, where there are definite indications of serious abuse or misconduct, to make public that supervision of the institution concerned is being intensified.
- Where findings regarding an individual institution are positive, DNB may also consider publishing them, with the consent of the institution concerned, in order to influence the sector.
- DNB can make better use of existing publications of sanctions and penalties in order to create a general preventative effect in the financial sector.
- DNB can use the publication of supervision information about groups of institutions even more effectively by communicating more clearly and extensively about risks and supervision outcomes and effects relating to specific institutions and institutions in general.

We will look to strike a new balance, taking account of the public’s need for information and the power of transparency as a supervision instrument while at the same time recognising that there are limits to the transparency that a prudential supervisor can achieve.
4 What can other stakeholders contribute?

Supervision is not conducted in a vacuum. Other stakeholders are instrumental in determining whether DNB succeeds in reaching its objectives. In this section, we will examine in more detail their role in achieving and preserving a stable and sound financial sector. First, we will mention in brief the main stakeholders and their responsibilities. We will then go on to consider the role of prudential and non-prudential legislation.

4.1 The role of other stakeholders

- The main external stakeholders able to contribute to a safe and sound financial sector are the supervised institutions themselves. First and foremost, the institutions themselves are responsible for regaining public trust. Second, DNB expects these institutions to make a constructive contribution to addressing the challenges facing them both individually and as a group.

- The authorities (government and Parliament) are responsible for putting in place effective prudential legislation and regulations. A good supervisor should provide the authorities with feedback from its supervisory practice about the effectiveness of the existing supervision tools and point out where gaps exist. To this end, DNB has regular consultations with official level bodies and produces annual legislative letters to the Minister of Finance and the Minister of Social Affairs and Employment. By taking timely action on this information, the government can help the supervisor in the effective discharge of its duties. The government can exert influence on the soundness of the financial sector in other ways as well, for example through tax legislation.

- Other supervisors too, both in the Netherlands and abroad, can help to improve the effectiveness of prudential supervision: supervisory boards, audit, risk and compliance departments, external auditors and rating agencies all play a role in promoting sound and ethical business practices. If they do their job properly, this facilitates the task of the prudential supervisor. DNB has its own responsibility for carefully assessing to
what extent it can rely on the work performed by these parties. This form of supervision is not a substitute for prudential supervision.

- An essential building block of our supervision continues to be close cooperation with the AFM. In this respect, both DNB and the AFM act within their own remit and in the knowledge that they have a common mission, i.e. to work to restore trust in the financial sector and contribute to the stability of the financial system. Prudential and business conduct supervisors need each other in order to carry out their duties effectively, particularly in difficult supervision cases where joint action has been shown to greatly enhance effectiveness. Here one can think of preventing overlap and gaps in supervision, and making use of each other’s expertise and information. The necessity of cooperation will not change with the introduction of the SSM.

4.2 Prudential regulations

As said, many prudential regulations pertaining to the financial sector have been tightened in recent years. But there is still a lot to be done at both the European and national level.

- Transition to the full introduction of Basel III/CRD IV.
- Introduction of the theoretical solvency criterion in order to facilitate more risk-oriented and forward-looking supervision of insurers, pending Solvency II.
- A Solvency II agreement designed to introduce risk-oriented supervision and a level playing field on a European scale.
- Swift introduction of a new financial assessment framework for pension funds.
- Development of an effective resolution mechanism, supported by a European resolution fund, which helps to solve the problem of banks being ‘too big to fail’.
- Adjustment of legislation and regulations where necessary, in order to facilitate greater transparency, for example regarding publication of key data of banks and cost transparency of pension funds.

This is an extensive list, but action is absolutely necessary in order to repair the serious gaps that have come to light as a result of the crisis. Hence, we do not agree with the criticism that is again being voiced in some quarters that tightening up financial supervision causes an unnecessary regulatory burden. These points for action involve urgent repair work needed to reduce the likelihood of a financial crisis occurring again in the Netherlands in the future. In some respects, Dutch regulations are stricter than their European counterparts, but this is with good reason. A small country with large banks is exposed to specific financial stability risks. In the Netherlands, these are being addressed by requiring the major banks to establish extra buffers. We have also become stricter on remuneration. This is because the public outcry in the Netherlands about banks’ remuneration policies is hampering the desired restoration of trust in the sector. Likewise, the vulnerable position of the insurance sector in the Netherlands and the inadequacy of Solvency I have made it necessary to introduce additional requirements in anticipation of Solvency II.
Nonetheless, the supervisor and the legislator must be aware of the cumulative effect of rules and regulations. The profitability of financial institutions must not be needlessly hampered as this will limit the scope for recovery. This is why caution should be exercised in introducing a financial transactions tax and a bank tax.

The flood of new and more detailed rules, particularly at European level, does not necessarily guarantee a more stable financial sector either. First of all, we must take care to ensure that more detailed regulations do not induce a box-ticking mentality in supervision activities and in the financial sector. A financial institution that complies with all the rules is not necessarily a safe and sound institution. This is why forward-looking supervision is important. In addition, more rules also create more opportunities and incentives for circumventing them and shifting financial activities and risks to unregulated institutions. This is to some extent an inevitable side-effect of financial legislation, but legislators and supervisors should be aware of these effects.

4.3 Other legislation

Non-prudential legislation also plays a role in achieving our objectives as a supervisor and an authority responsible for promoting financial stability. An important example of this is tax legislation, which in recent decades has been in a major factor in determining the present scope, structure and risks of the Dutch financial sector through its influence on the conduct of institutions and their customers. The combination of generous mortgage interest relief, tax relief on endowment policies linked to home ownership and tax relief on pension contributions (the ‘Witteveen framework’), for instance, has contributed to the accumulation of imbalances in the Dutch economy and the financial sector. As a result, banks built up large mortgage portfolios and became unduly dependent on market financing; households ran up large mortgage debts while having substantial pension assets, and insurers devised and sold complex products on a large scale, thereby causing substantial reputational damage and excess capacity. The policy of providing a tax-friendly climate for the business community has created a substantial trust sector, which involves relatively high integrity risks and consequently, reputational risks for the Dutch financial sector.

Support for favourable tax treatment of accrued debt is on the wane in the Netherlands. DNB welcomes this and is glad that tangible steps are being taken to limit mortgage interest tax relief. As business models have become dependent on the tax system over time, it would be advisable to scale back the tax relief facility gradually and predictably, and in parallel with the restoration of capital buffers. This means that we are in favour of a step-by-step reduction of the loan-to-value ratio by 1 percentage point per year, as proposed by the government. Provided that it happens gradually, a reduction is desirable not only to lower the levels of household debt, but also to ensure sound bank balance sheets.

Policies targeted at changing the structure of the financial sector and individual institutions can also help us achieve our supervision objectives. We have already mentioned the importance of tools for the
effective resolution of insolvent banks. Recovery and resolution plans, sometimes known as living wills, are an essential part of this. This is not only because they enable the resolution authorities to wind up banks without major risks to financial stability and the taxpayer, but the plans also encourage banks to simplify their legal and operational structure as a going concern, which helps to reduce management complexity and mitigates prudential risks.

The Ministry of Finance’s evaluation of the Intervention Act following the nationalisation of SNS should also be mentioned in this respect. This Act confers powers on DNB and the Ministry of Finance to take measures with respect to financial institutions in difficulties. The Ministry concluded that the legislation would be more effective if DNB were also able to exercise the right of transfer, subject to conditions, in relation to the parent company of a bank or insurer. In practice, a situation may occur in which allowing a holding company to go bankrupt is judged to be undesirable in view of its effect on a bank or insurer that is a member of the group concerned. In such circumstances, the possibilities of achieving an effective solution would be enhanced if DNB were also to have powers in respect of the holding company. It should be noted that the Intervention Act will in any event have to be amended in order to transpose the provisions of the Bank Recovery and Resolution Directive into national law.

In addition, public debate has ignited about whether additional reforms are necessary to the structure of the banking sector in order to allow for safer and better resolution. This question has been considered by the Vickers Commission in the UK and by the Liikanen Group at European level. In the Netherlands, the Commission on the Structure of Dutch Banks has issued advice on structural reform, and has largely adopted the proposals of the Liikanen Group. Part of this is a duty to hive off trading activities if they exceed a given limit.

DNB endorses the position taken by the Commission on the Structure of Dutch Banks and the government (as set out in the Government View on the Dutch Banking Sector) on the separation of banking activities. It should be noted that the intended measures will at present not have any material impact on Dutch banks as their trading activities are too small to trigger this provision. In general, we are sympathetic towards most of the current proposals for reforming the structure of the banking sector, but would note that this should not be at the expense of legitimate and successful business models based partly on utilising synergies. The universal bank, in particular, is a business model that is successful in the Netherlands and therefore deserves to be preserved, also with a view to maintaining the competitive position of Dutch banks in Europe.
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