

CREDIT LOST

Summary in English

**Report of the Parliamentary Committee Inquiry Financial System
Tweede Kamer der Staten-Generaal
(House of Representatives, Netherlands Parliament)**

10 May 2010

I Background to and structure of the inquiry

In 2007, the world was shocked by the rapid increase of problems in the financial sector, which were caused largely by problems in the mortgage market in the United States. Since that time, uncertainty and ambiguity regarding the assessment and appraisal of the financial position of financial institutions have led to a strong decrease in confidence in these institutions. This situation brought many financial institutions into serious financial trouble in 2008 and 2009, and it put pressure on the stability of the international financial system. Many governments (including the government of the Netherlands) have responded by providing massive financial injections to support financial institutions, in the hopes of preventing the further collapse of the financial system. These actions were based on the knowledge that an adequately functioning financial system is of great importance to the functioning of our economy. Developments since 2007 have demonstrated that problems in the financial system can have a major influence on the economy and on our prosperity, with a financial crisis as a result.

The effect of the financial crisis on the economy, on society and on government finances induced the House of Representatives to launch a parliamentary inquiry into the causes of the financial crisis, the results of which were to be used as a foundation upon which to formulate recommendations for improvements in the financial system. The Finance Committee presented a proposal to this end to the Presidium of the House of Representatives on 10 June 2009. The proposal was based on the principles and assumptions that all of the parliamentary group leaders had established for this specific parliamentary inquiry. On 23 June 2009, the House of Representatives unanimously approved the Presidium's proposal to hold a parliamentary inquiry into the crisis in the financial system and to have this inquiry conducted by a temporary inquiry committee. The Temporary Committee Inquiry Financial System (hereafter, the Committee) was established on the same day.

One of the starting assumptions formulated by the group leaders is that the parliamentary inquiry into the financial system would be conducted in two parts. The first part of the inquiry would focus on charting the causes of the turbulent developments, structural problems and the measures taken in the financial system. The results of this would then be used to make recommendations for the further structural improvement of the system. This report is the result of this process. The second part of the inquiry will focus on evaluating the Cabinet's interventions in the financial sector since 28 September 2008. This was the date of the first governmental intervention: the Netherlands, Belgium and Luxembourg pledging government participation in Fortis. The second part of the inquiry will begin after the elections of 9 June 2010.

Composition of the committee

During its inaugural meeting on 24 June 2009, the Committee elected one of its members, Jan de Wit, as chair and another member, Jan Schinkelshoek, as vice-chair.

The committee consists of the following members of the House of Representatives:

- Jan de Wit, (SP), Chair
- Jan Schinkelshoek (CDA), Vice-chair
- Luuk Blom (PvdA)
- Edith Schippers (VVD)
- Dion Graus (PVV)
- Jolande Sap (GL)
- Ernst Cramer (CU)
- Fatma Koser Kaya (D66)

Inquiry assignment

In the adopted inquiry proposal, the House of Representatives specified that the goal of the parliamentary inquiry is to contribute to the proper functioning of the financial system in general, and particularly in the Netherlands. According to this objective, the following twofold problem statement was formulated in the inquiry proposal:

‘What are the causes of the recent turbulent developments in the financial system and which recommendations for a more properly functioning system can be made according to the findings?’

Inquiry approach

In recent years, much has been said and written across the globe regarding the causes of the financial crisis. Scientists, parties within the financial sector, politicians, supervisory authorities, policymakers, journalists and many others have stated their insights and opinions concerning the causes of the crisis in the financial system and the question of what improvements are possible. The Committee conducted a literature study in order to compile an inventory of the available information that would outline the various causes and possible improvements that have already been mentioned by others. The Committee also commissioned Utrecht University to conduct an inventory and analysis of the legislation and the system of supervision regarding the financial system. The results of this inventory have been included as two separate component studies within this Committee report.

From 18 January 2010 until 4 February 2010, the Committee held a total of 40 public hearings with 39 people. These hearings involved a combination of scientists, experts, researchers, and responsible parties within the Dutch financial sector, Dutch supervisory authorities and politicians. The most important aspects of the financial crisis and the financial system were discussed extensively during these hearings. Verbatim transcripts of the hearings are included as an annex to the complete (Dutch language) version of this report.

The Committee selected two cases for more in-depth analysis during the parliamentary inquiry. The first case involves the events occurring around the takeover approval of ABN

AMRO in 2007. The second case involves the events occurring around the introduction of Icesave in the Netherlands by Landsbanki, and the subsequent collapse of Landsbanki.

II Main conclusions and recommendations

Undiminished need for reflection and change

The bankruptcy of the American investment bank Lehman Brothers in September 2008 confirmed the existence of a systemic crisis in the financial system. This crisis of the financial system had enormous effects on the global economy, which continue to the present day. Many economies were plunged into recession, and governmental deficits increased sharply, due in part to government efforts to support or intervene in the financial sector. The negative effects of the crisis clearly show the importance of a well functioning financial system for our society.

The crisis calls for serious and critical reflection by all parties involved in the financial system regarding the manner in which the financial system is organised and how it has functioned, particularly with regard to the financial sector, but also with regard to legislators, supervisory authorities and consumers and businesses. In recent years, such reflection on the financial crisis has taken place in various ways and in various places. The Committee nonetheless ascertains a decrease in attention to the results of this reflection and to the actions that are needed. The sense of urgency for ushering in the structural changes to reduce the likelihood of a similar crisis in the future appears to be decreasing.

According to the Committee, the time has not yet come to return to business as usual with regard to the changes that are needed within the financial system. Several important factors that served as the causes of the crisis in the financial system are still present, both in the structure of the system itself and in the culture and conduct of those within it. These factors could once again cause problems in the financial system in the near future. This raises an urgent question regarding the extent to which governments that are already in financial trouble would be capable of coping with the effects of another financial crisis. In such a situation, the effects on society could be many times greater than they are at present. In this light, the Committee argues that the results of reflection on the financial crisis should be deployed in a more active and ambitious way in the form of analyses, proposals and measures.

This plea is directed towards all parties involved in the financial system. Given the parliamentary status of the committee, it is particularly directed towards the legislature in the Netherlands. Awareness of the special and important position of the financial system and financial institutions within society is not a new phenomenon. Considerable consensus has existed within the political arena since the 1930s that important public interests are attached to the proper functioning of the financial system and that the government should protect these public interests in some way. At a minimum, such protection should involve the accessibility, reliability and affordability of money transfers, credit and savings facilities.

The most tangible result of this awareness is the specific legislation for supervision of the financial sector. It can be established that the current legislation and the associated supervision were incapable of preventing the global crisis in the financial system. They were also incapable of preventing the crisis in the Netherlands. This situation calls for Dutch authorities to reflect on the way in which they have fulfilled their role and duty within the financial system in the past, the changes that are desirable in this regard and the concrete action that these changes will require.

As its first assignment, the Committee was charged with compiling an inventory of the causes of the crisis in the financial system and proposing relevant improvements. With its report, the Committee is fulfilling this assignment and contributing to reflection. This summary recounts the most important points of the conclusions, presenting them in relation to the actions recommended by the Committee.

A global financial crisis:

Improvements are needed in the recognition of macro-economic risks

The direct precipitator of the financial crisis was the bursting of the housing-market bubble in the United States, which occurred when it became apparent that many bad mortgages had been issued. The dispersion of the risks of these loans throughout the financial system and the opacity regarding who would bear these risks led to far-reaching consequences for the financial sector and, subsequently, for the actual economy.

The deeper causes of the crisis in the financial system, however, are located in the international macro-economic realm (trade and monetary policy, globalisation and the liberalisation of financial markets). Within this field, and with the help of technical and scientific innovation, financial institutions have increasingly engaged in issuing credit and in trading loans and credit risks on the capital market. Consumers and companies began borrowing more money, burying themselves deeper and deeper in debt.

Few predicted this financial crisis, and even fewer predicted its scale and the moment at which it would manifest itself. Nonetheless, the underlying economic mechanisms that lay at the foundation of the crisis are a variation on the well-known theme of low inflation, strong economic growth, higher credit, greater risk-taking, greater debt for households and companies, and the emergence of speculative pricing bubbles. The Committee has ascertained that the most important advisors to the Dutch government and legislature, the Netherlands Bureau for Economic Policy Analysis (CPB) and De Nederlandsche Bank (DNB), admittedly did point to the global developments outlined above. However, these institutions also failed to recognise the exact nature of the relation between risky international macro-economic conditions and the financial system, and they underestimated the potential effects thereof. Partly for this reason, the CPB did not adjust its public prognoses for the economic developments until a late stage.

The Committee considers it of great importance for policymakers and legislators to have access to good and usable information in the future regarding the risks of macro-economic

developments, as well as information on developments in the financial system and possible policy options for managing or preventing the associated risks.

As the most important economic advisor to the government, the CPB has since reported that it will be reinforcing its knowledge and expertise in the area of financial markets in response to the crisis. Further, a department for macro-prudential analysis has recently been established within DNB.

Recommendation 1:

Provision of information regarding macro-economic risks to the financial system

The Committee recommends that the CPB and DNB jointly inform the legislature at least once per year about international and national macro-economic developments in the financial sector. Their reports should focus on the risks that macro-economic developments pose to the stability of the financial system and vice versa, both in general and for the Netherlands in particular. In addition, the CPB and DNB should indicate the possibilities and policy options that are available to the Netherlands for the further management of these risks, as well as the policy considerations that are involved. The reports should also indicate the legislative adjustments that the CPB and DNB consider desirable. They should also report the progress that these institutions have made in the development and use of macro-economic policy models, paying explicit attention to the financial sector. These reports are to be separate from the existing, regular reports submitted by these institutions. The CPB and DNB are to present their information to the legislature in the form of a joint report, to appear in the first quarter of each year, accompanied by an explanation of the report to the House of Representatives. They are to provide similar joint reports more frequently if macro-economic developments or developments within the financial system demand this.

Responsibility of the financial sector:

Changes needed in structure, culture and conduct

The actions of the dominant actors within the system – financial institutions – played a major role in the emergence of the crisis. The crisis has revealed clear shortcomings in the risk-management practices of financial institutions. Important risks within the financial system were systematically underestimated and/or not recognised, and the institutions had too little insight into the risks to their own balance sheets.

To varying degrees, this applies to financial institutions in the Netherlands as well. Partly for this reason, Dutch financial institutions suffered extensive losses during the crisis, and some were plunged into serious financial difficulties. The most important internal cause resides in the fact that evaluations weighing commercial interests (returns) against the associated risks placed disproportionate focus on the former, also within Dutch institutions. The increasing emphasis on creating shareholder value also played an important role within the financial sector in this regard.

The boards of directors of the financial institutions deserve the primary blame. The board of directors bears primary responsibility for corporate policy, and it should ensure proper risk management. The boards of financial companies underestimated, failed to see or consciously took risks, possibly stimulated by variable compensation structures and their own packages of shares and options. This caused serious damage to the interests of their institutions, of the entire financial sector and of society as a whole. In addition, the supervisory boards failed to live up to their responsibilities in fulfilling their supervisory and advisory functions. Finally, the shareholders of financial companies placed undue focus on creating shareholder value in the short term. In effect, this relegated the institution's long-term objectives, such as sustainability and continuity, to a position of secondary importance.

It must be concluded that the checks and balances in the Dutch governance model did not function adequately in the financial sector. The various bodies within this governance model did not play the roles that were expected of them. This attests primarily to the inadequate vision and insufficient attention to the creation of sustainable value among all parties directly involved. Dutch society ultimately paid the price in the form of a crippled financial sector, a stagnated economy and an immense mortgage on the future, in terms of a sharply increased government deficit.

With the Advisory Committee on the Future of Banks (the Maas Committee), and the Banking Code that was based upon it, the Dutch financial sector took an initial step towards improving the functioning of the financial sector and reclaiming the social credit that had been lost. The Committee concurs that the Banking Code contains many elements that could steer the financial sector in the right direction. Based on its inquiry, the Committee has added three remarks.

First, the Committee questions whether the status of the Banking Code – a form of self-regulation with a legal basis and a regime of 'comply-or-explain' – is firm enough to effect the changes needed within the financial institutions. A related question is whether the financial sector has sufficient discipline to act according to the spirit, and not just the letter, of the Banking Code. The Committee is of the opinion that financial institutions should have as little room as possible for making use of the option to explain their non-compliance with the Banking Code.

Second, the Committee is of the opinion that certain elements of the Banking Code do not go far enough in effecting the changes that are needed within the financial institutions. In the Committee's view, it will be necessary to sharpen the Code in the areas of compensation policy, risk management and the necessary changes in culture and conduct.

Third, the Banking Code applies to banks, which comprise only a portion of all financial institutions. The Committee finds that similar codes should be developed for types of financial institutions other than banks, including insurance companies and pension funds.

Recommendation 2:
Ensure compliance with the Banking Code

The Committee recommends that the financial sector promptly develop plans for the careful implementation of and compliance with the Banking Code, proceeding explicitly from 'comply' (instead of 'explain'). The initial results of the Banking Code Monitoring Committee will form the basis for determining the results of the chosen arrangements. For this to happen, the Monitoring Committee will have to make its initial findings known in short order. It will also be necessary to have a clear delineation of the normative framework used for evaluating the 'comply or explain' principle and the sanctions that could follow in cases involving the improper use of the option to explain. A legislative regulation to replace the recommendations in the Banking Code should remain a possibility. Lastly, the Committee recommends that the supervisory policies of DNB and the Netherlands Authority for the Financial Markets (AFM) explicitly address the manner in which financial institutions conform to the Banking Code.

Recommendation 3:

Supplement and intensification of the Banking Code in the area of risk management

In the Committee's opinion, further improvements are needed in the area of risk management within financial institutions.

The Committee recommends that the formulation of risk appetite, as prescribed by the Banking Code, be supplemented with explicit tests of the applied business models within a financial company. A clear distinction between various types of risk should also be applied. The distinctions between credit, market and investment risk appear to have become particularly blurred through financial innovation. More attention should also be paid to liquidity, concentration and counterparty risk. Clarity regarding the possible consequences of these risks would contribute to healthy and prudent management practices within financial companies. To this end, the repertoire of risk-management instruments should not be limited to quantitative models, but should include qualitative analyses and simulations as well. Lastly, the Committee recommends that internal accountants be more closely involved in risk management and be given a stronger position within the organisation of financial institutions. Given the potential impact of accounting on management practices and the associated risks, a weightier, stand-alone role is necessary. In the interest of monitoring the balance between commercial interests and the management and control of risks by the supervisory board, the internal audit function should also be strengthened.

Recommendation 4:

Supplement and intensification of the Banking Code in the area of compensation policy

In the judgement of the Committee, the scope of several compensation principles, as included in the Banking Code, the Principles of AFM and DNB, and the Cabinet's plans, should be extended to include the entire organisation. Examples include limits on severance pay and claw-back provisions. The Committee recommends that the principles for these purposes be formulated not only for directors and senior management, but for all functionaries within a company, particularly those who work in the dealing room. Such

agreements, however, need not be identical to those that apply to directors and senior management.

The Committee also recommends supplementing the Banking Code with regulations that will limit retention, exit and welcome packages, to the extent that they lead to adverse incentives. Imposing limits on variable compensation must not lead to excesses in these or other components of compensation. The primary goal is to achieve a balanced reward structure that avoids adverse incentives. The key phrase in this regard is 'No profit, no bonus'. The compensation framework should be explicit and transparent so that a financial institution can be held accountable for it.

Recommendation 5:

Limits on compensation as a condition for state support

The Committee agrees with the Minister of Finance's proposal to impose far-reaching conditions regarding the compensation of directors in financial companies that receive government support. More specifically, the consequences for the compensation of directors should be identical to those that apply in cases of bankruptcy: outstanding option or share packages and conditionally approved long-term bonuses will be cancelled. The supervisory board should determine whether it is possible to retrieve bonuses that have been paid out in the past. In this case as well, the scope of these regulations should be extended to include the entire organisation, if possible. If necessary, the legislation should be adjusted to allow for this possibility.

Recommendation 6:

Careful reinforcement of the supervisory board

The Committee agrees with the elements in the Banking Code that are directed towards reinforcing the quality of supervisory boards. The Committee adds the caution to guard against a one-sided focus on the substantive expertise of directors in the financial world. Although the supervisory board of a financial institution as a whole should possess sufficient knowledge and expertise regarding the banking business and the financial sector, this does not automatically apply to every member of the supervisory board. The emphasis on assessing the substantive expertise of directors should not be allowed to lead to the predominant appointment of insiders to the financial sector. It is important for a healthy diversity to emerge within the supervisory board with regard to background, knowledge and expertise.

The Committee recommends that, when assessing the expertise of supervisory directors, the supervisory bodies DNB and AFM should consider the composition and background of the entire supervisory board, looking at such matters as the knowledge, expertise and diversity that already exists or that is lacking. In this regard, explicit attention should be paid to the amount of time supervisory directors are expected to commit, as well as their autonomy.

Recommendation 7:

Changes needed in the culture and conduct of the financial sector

The Committee is of the opinion that changes are needed in the conduct of those in positions of responsibility in the financial sector. This is primarily a task for the sector itself and for the individual financial institutions. The financial sector should develop a vision of its future and the social responsibility that is associated with it. The Committee calls upon the sector to develop this vision promptly and to anchor it in the Banking Code.

The Committee recommends requiring financial institutions that are under supervision to compile a plan of approach for how they will fulfil their social responsibility. In this plan of approach, the institution will state its policy for effecting the necessary cultural changes within the institution. This can be done with the aid of a cultural audit. The plan of approach will also state the manner in which the institution will ensure sustainable development in the social, ethical and environmental aspects of its business operations.

The Committee also recommends that institutions account for the implementation of these plans of approach in their annual reports. The supervisory bodies DNB and/or AFM will monitor the progress of the development and implementation of these plans of approach, and they will consider these findings in performing their supervisory duties.

Recommendation 8:

Codes for other financial institutions are desirable

The Committee recommends that financial institutions other than banks (for example, insurance companies, pension funds and investment corporations) establish their own Codes. Many elements of the Banking Code can provide a foundation for such codes, as can the Committee's recommendations, as described above. The recommendations regarding compensation, risk management and the supervisory board are thus applicable to financial institutions in general, and not only to banks.

Recommendation 9:

Responsible shareholdership

The Committee supports initiatives aimed at achieving sustainable shareholdership, including loyalty dividends and voting rights, which are directed towards the creation of value in the long term. Such initiatives enable shareholders to exercise their rights and duties responsibly.

The legislator's responsibility:

Sharpening regulation and strengthening the role of the national parliament

With regard to the financial crisis and the role of legislation therein, the Committee feels justified in concluding that the regulation of financial markets has fallen short. Based on its inquiry, the Committee has established that adjustments in legislation for the financial system and the financial sector since the 1990s have been directed towards further liberalising financial markets (particularly those in Europe) through the harmonisation of national regulatory guidelines, thereby creating a level playing field for financial institutions. Partly in

view of its relatively large financial sector and in the interest of an open economy, the Netherlands has positioned itself as a proponent of this development.

Regulatory guidelines have rarely been able to achieve a situation in which financial institutions have kept the sharply increased risks within the financial sector under control. The crisis has made a number of weak spots in the legislation painfully obvious. Most importantly, it was possible to set the capital requirements for financial institutions too low. This has resulted in an insufficiently disciplinary effect of these capital requirements on the process through which financial institutions evaluate and take risks. The applicable accounting regulations have played a role as well. These regulations made it possible to maintain a lower capital base for certain products than would be justified according to the risks. It can also be established that important parts of the financial system were barely regulated, if at all. Within this 'shadow banking system', professional parties were expected to be able to connect supply with demand and develop accurate estimates of the risks of their activities independently and efficiently. In hindsight, this was not the case, partly because of the lack of transparency concerning these risks and because of the search for higher returns.

These conclusions warrant an evaluation of the role of Dutch legislators and self-reflection on the part of the House of Representatives. The Committee feels justified in concluding that the House of Representatives was not active enough on at least two points in recent years. First, the House of Representatives underestimated and insufficiently discussed the early warning signs that had been expressed by authoritative sources regarding undesirable developments in the macro-economy and developments in the financial system. Partly for this reason, the House of Representatives made too few critical remarks prior to the crisis regarding the prevailing paradigms concerning financial markets (and the regulation thereof), the resulting structure of the financial system and the associated adjustments in legislation. With regard to the financial system, the House of Representatives also invested too little in its own knowledge development and research. This posed an obstacle to its ability to continue a well-informed dialogue with the government and supervisory authorities regarding the principles and key points of the financial system. For this reason, it was difficult for the House of Representatives to influence developments effectively. In some cases, it led to ad hoc decision-making processes, which were vulnerable to influence by interest groups through lobbying.

Second, the House of Representatives often learned too late of important initiatives regarding the development of international and European standards and regulations; it neglected to enter fundamental debate with the Cabinet over these issues, or waited until the process of negotiation had progressed to a point where it could no longer influence the process.

Following many others, the Committee concludes that reform and adjustment of the legislation for the financial system is both necessary and urgent. The Committee agrees with a large number of initiatives that have emerged since the onset of the crisis to adjust and sharpen legislation. The Committee would like to point out the necessity of preventing the

following crisis in the financial system from being a legislative crisis, caused by the hasty acceptance of poorly considered new legislation for the financial sector that was not evaluated in context. Good regulation is preferable to more regulation. In the Committee's judgement, an important fundamental starting point for the reform of the financial system should be expansion of the inherent security of the financial system. This implies that risk-taking by actors is always associated with costs, that these costs must be high enough to prevent systemic risks from reaching socially unacceptable heights and that it should not be possible to shift these costs to society or to the financial system as a whole. The numerous proposals for the reform of the sector should be evaluated in this regard. In the section below, the Committee identifies the initiatives that it feels should have priority and where the legislation should be adjusted.

Recommendation 10:

Regulations should preferably be global or European, but national if necessary and possible

Because of the entangled nature of the financial sector on both global and European levels, a global and European approach to the regulation of the financial sector is preferable. Guaranteeing the stability of the financial system in the Netherlands would be best served by such an approach. If a desired adjustment in the legislation cannot, or not sufficiently, be realised in a global or European context, the option of developing legislation at the national level should receive more consideration than it has in the past. In discussions with Parliament concerning the results of international or European negotiations, the Cabinet should explain the national options and policy space more emphatically, in addition to its considerations for choosing a particular policy line and the consequences thereof. Because of the relatively large scale of the Dutch banks in relation to the Dutch economy and Treasury, the Committee deems that the European member states should make binding and non-ambiguous agreements regarding the distribution of costs (burden sharing) for any governmental interventions in the financial sector. This should apply at least to governmental interventions in systemic European banks. The Committee recommends that the Cabinet assign priority to these efforts during its discussions in the relevant European decision-making bodies.

Recommendation 11:

Gradually raise the minimum capital requirements with cyclical reserves

One of the best ways to couple the costs and benefits of risk taking would be to raise the minimum capital requirements for financial institutions. The Committee is a proponent of a considerable increase in these capital requirements, to be implemented gradually. In this regard, the Committee aligns itself with the reforms introduced by the Basel Committee ('Basel-III') and argues for their prompt introduction into European and national legislation. The Committee also supports the Basel Committee's efforts to counteract the pro-cyclic effects of the capital-requirements system as much as possible. One way would be to encourage banks to build up 'economic cyclus reserves' or a 'nest egg' during favourable

times in addition to the required minimum capital; banks can then draw upon these reserves during less favourable periods. These reserves should however not be used to balance profits, and its accumulation should be transparent, and adequately accounted for. This will require adjusting the accounting standards of the International Financial Reporting Standards (IFRS). The Committee emphatically points out that capital requirements specify minimum requirements and that DNB is thus free to set higher requirements for individual institutions for micro or macro-prudential reasons.

Recommendation 12:

Separate commercial and investment banking activities within the same institution

The Committee is of the opinion that a bank's investment banking activities should incur no risks to savings deposits that fall under the deposit-guarantee scheme. For this reason, investment banking activities (intermediation in capital markets) should be separated from commercial banking activities within a single institution. Known as ring-fencing, this process allows banks to keep their utility functions (for example, money transfers, savings deposits and loans) separate from their more speculative activities, which may not serve the primary interests of clients. This means that such activities as proprietary trading should have a strong capital base separate from the savings deposits that are maintained within the bank. Ring-fencing would force banks to operate more cautiously, and it would prevent serious problems involving investment banking activities from infecting the rest of the company. It would also limit the consequences for the government and taxpayers of any problems that might arise.

Recommendation 13:

Assessment of financial stability as an important criterion for takeovers and mergers

In light of practices in many European countries, the Committee is of the opinion that political whims should play no part in the assessment of acquisitions and expansions of shareholdings (for example takeovers or mergers) within in the financial sector. The Committee supports this objective of the Antonveneta Directive.

The Committee believes that takeovers, mergers and similar processes involving financial institutions should be examined in advance for their effects on the stability of the financial system. The interpretation of this macro-prudential test should be broader than the interpretation of the Minister of Finance during the takeover of ABN AMRO. The Committee recommends working out the test for financial stability into objective prudential criteria. In the Committee's judgement, these criteria should be explicitly included in the Antonveneta Directive so that no misunderstandings can arise regarding whether this test should actually be carried out. The Committee recommends that the Cabinet work to achieve this at the European level.

Recommendation 14:

Expand the government's repertoire of instruments for intervention

The Committee supports the Cabinet's plans to expand the repertoire of instruments for governmental intervention in financial institutions with an 'intervention ladder' of various possibilities for early correction that increase in strength. Instead of the ordinary supervision that applies under normal circumstances, the supervisory authorities can apply sharpened supervision. They can instruct institutions to resolve particular problems or impose immediate corrective measures with force. In situations of acute danger to an institution's liquidity or solvency, the authorities themselves can intervene directly within the institution. The Committee also agrees with the new intervention instruments proposed by the Cabinet, including the conversion of subordinate borrowed capital. This would prevent institutions from entering the most serious problem phase – bankruptcy.

Recommendation 15:

European deposit-guarantee scheme with risk-related ex-ante financing

The current deposit-guarantee scheme, which is financed after the fact by banks and, as a last resort, by the government, provides insufficient incentives to institutions to limit their risks. The Committee supports the Cabinet's plans to transform the current scheme into one in which banks would deposit risk-related premiums into a deposit-guarantee fund in advance. The risk profile according to which the premium is calculated would be set by the supervisory authority. Ideally, this scheme would be introduced at the European level as well, including a regulation for possible burden sharing. For example, the costs associated with the bankruptcy of an institution could be apportioned to the country in which the savers are based. The Committee recommends introducing the proposed financing method (ex ante payment of a risk-based premium) in the Netherlands as soon as possible, in anticipation of a European regulation. In anticipation thereof, the Committee recommends imposing additional requirements for entrance into the Dutch deposit-guarantee scheme.

The Committee further recommends lowering the current guarantee amount specified in the Dutch deposit-guarantee scheme (€ 100,000) to its level from before the crisis, consistent with the European context and the proposed ex ante financing of the deposit-guarantee scheme. This measure would protect savers, but without enticing reckless behaviour on the part of banks and savers.

Recommendation 16:

Bank levy

The Committee is familiar with the discussion at the European and global level regarding the possible introduction of a bank levy. It is also aware of the Dutch government's standpoint in this discussion. Should such a charge be adopted, the Committee is of the opinion that the level playing field for financial institutions should be maintained. The global (or at least European) level is therefore the appropriate level of regulation. If the choice is made to introduce a levy of a permanent nature, then this should at least be related to risk, in order to stimulate banks to adopt responsible risk policies. The possible introduction of a levy should be carried out in consideration of other measures that have been initiated and of cumulative effects.

Recommendation 17:

Increased parliamentary scrutiny of financial sector reform

The Committee recommends that the House of Representatives intensify the fulfilment of its controlling and legislative duties with regard to the reform of the financial system. The Finance Committee is primarily the appropriate committee for implementing this intensified parliamentary scrutiny. The Committee recommends beginning promptly, analogous to or within the context of the Major Project Provisions.

Recommendation 18:

Transparency in extra-parliamentary influence and lobbying activities

The Committee recommends that the House of Representatives investigate the possibility of increasing the transparency of stakeholder influence on the content and realisation of legislation. One option would be to consider a system of legislative footprints, in which legislators indicate which actors were involved in compiling regulations and in what ways.

Accountability of the supervisory authorities:

Improve content and execution of supervision

In addition to gaps and shortcomings in the legislation for the financial sector, the crisis has also revealed the global inadequacy of supervision aimed at preserving the stability of the financial system and financial institutions. The crisis has revealed a global lack of systemic supervision, that is to say supervision aimed at identifying risks to the financial system as a whole as well as solutions. This is caused partly by the fact that supervision is performed at the national level, despite the global character of the many systemic risks. In addition, many of the activities within the financial system take place outside the scope of the applicable legislation, thus greatly reducing or eliminating the possibility of supervision. The supervision of the financial system also had an unmistakable excessive focus on evaluating and safeguarding the health of individual institutions (micro-prudential supervision). This focus was based on the assumption that, if individual institutions are healthy, the system will be healthy as well.

These shortcomings in system supervision were also present in the Netherlands. In general, the party responsible for supervision, DNB, publicly addressed the systemic risks of which it became increasingly aware. Either these warnings were insufficiently heard, or they failed to convince policymakers and politicians. It is remarkable that the systemic risks identified by DNB did not lead to action by the supervisory authority at system level. In addition, in performing its supervisory tasks, DNB focused largely on the business operations of individual institutions (micro-prudential).

It is not possible for the Committee to establish the extent to which DNB performed its tasks as a micro-prudential supervisor adequately. This is due to the strict confidentiality surrounding the supervision performed by DNB, even with regard to parliamentary inquiry.

The Committee can however establish that the micro-prudential supervision of the upright conduct of business was performed in too limited a fashion prior to the crisis. For this reason, crucial developments, such as those taking place in compensation policy, were not recognised as risks to the prudent conduct of business.

Much of the Dutch legislation for the supervision of conduct is of recent date, as is the supervisory authority AFM, which is responsible for the supervision of conduct. It can be established that the negative effects proceeding from elements in the compensation policy (short-term perspective) within the financial sector and developments in the culture within financial institutions also received insufficient attention from the supervisory authority for conduct (AFM).

The financial crisis revealed that the financial accounting information that financial institutions provided to shareholders and other users was insufficient for identifying the major risks within the institutions or the financial system. The Committee has established that the controlling authorities and the accountancy organisations were incapable of warning that the continued existence of certain banks was under serious threat or that there were major risks in the financial system.

Recommendation 19:

Reinforce supervision at the European level

The crisis has exposed the limitations of national supervision on an international playing field. The Committee recommends working vigorously on the European supervisory system. The recommendations of the High Level Group directed by De Larosière are a starting point in this regard, but no more than that. The goal must be a single, strong European supervisory authority that has all the means necessary to perform effective supervision over trans-boundary financial institutions and activities, and which also has the necessary power of enforcement. This applies to both micro-prudential and macro-prudential supervision. In light of the problems that occurred in this area (for example with Icesave), the Committee strongly emphasises that, in anticipation of the construction of the European system, the exchange of supervisory information between various national supervisory authorities can be enforced if necessary. The basis for this exchange should be transparency towards each other instead of mutual trust.

Recommendation 20:

More transparency in the execution of supervision

The Committee is of the opinion that additional transparency is desirable in the execution of financial supervision in the Netherlands. The Committee recommends that the supervisory authorities DNB and AFM exercise more openness and transparency towards institutions, the government and the public in performing their supervisory activities. The Committee is of the opinion that the boundaries of the legal provisions regarding confidentiality should be stretched. This is consistent with the possibilities existing in the European context and with

common practices in other countries. In this regard, the Committee recommends that DNB shift to the periodic publication of solvency information (as is currently the practice in Switzerland and other countries) and relevant public data concerning all institutions falling under its supervision.

Recommendation 21:

Closer cooperation between supervisory authorities and the Ombudsman for Financial Services

The Committee recommends that the Ombudsman for Financial Services (Kifid) be included in the confidentiality range of the AFM and DNB. To this end, the Ombudsman for Financial Services should receive a public-legal status. This would allow a more effective exchange of information between the supervisory authorities and the ombudsman, and it would allow these parties to recognise and address prudential or market-conduct risks in an early stage.

Recommendation 22:

Supervision of institutions and markets previously falling outside supervision

In the Committee's judgement, institutions and markets within the financial system that are currently not yet (or only partially) under supervision should be brought under supervision. This applies particularly to credit-rating agencies, but also to such entities as hedge funds (which admittedly played a limited role in the emergence of the current financial crisis, but which are accompanied by risks). It is highly desirable that such supervision be arranged at the global or at least the European level, in the interest of maximising the effectiveness of supervision and maintaining a level playing field.

The Committee further recommends that the Dutch government and supervisory authorities support as much as possible international initiatives aimed at letting trade in Credit Default Swaps and similar take place through regulated stock exchanges with central clearing and settlement.

Recommendation 23:

Improve instruments for supervision and enforcement

The Dutch supervisory authorities themselves pointed out the necessity of expanding and improving the repertoire of supervisory instruments. The Committee concurs. In addition to the efforts at the European level, supervision should be improved at the national level.

The increased attention of DNB to macro-prudential analysis should lead to more effective supervision. The Committee would like DNB to state promptly the manner in which it will structure this systemic supervision, the instruments that can be used in this regard and any additions that are desired.

The approach to supervision should be improved and adapted to current practices at the micro-prudential level as well. Particularly in the area of monitoring liquidity, much more attention should be paid to underlying patterns and processes, given that liquidity indices at a given moment mean very little in a time when internet banking allows a bank run to occur in a matter of minutes, as the case of Icesave has demonstrated. A more substantive approach is

also desired for the supervision of solvency and market conduct, in addition to statistical analysis.

The Committee recommends that the supervisory authorities DNB and AFM also provide an evaluation of the setup and functioning of the Product Approval Process for financial institutions as part of their supervisory activities.

Recommendation 24:

Expand the reach of supervision by raising the financial boundary of the licensing requirement

Currently, financial-services providers requesting more than € 50,000 or with total issues of less than € 2.5 million are not subject to licensing or prospectus requirements. This means that these activities fall outside of the AFM's supervisory jurisdiction. This exemption amount assumes that investors above this limit can be considered professional investors.

In the Committee's judgement, this limit is too low and should be adjusted upward.

Recommendation 25:

Internal improvement of supervisory authorities

Changes and improvements are needed within the Dutch supervisory authorities themselves as well. The Committee requests that supervisory authorities also engage in critical introspection. The Committee furthermore recommends supplementing available knowledge and expertise with practical experience to a greater degree. A system in which supervisory authorities accompany employees within institutions can contribute in this regard, as can the periodic involvement of outside expertise.

The Committee also finds that supervisory authorities should examine the culture within their organisations. Attention should be paid to the balance of interests that the supervisory authorities should take into consideration – society, consumers, shareholders, employees and financial institutions. The Committee is also of the opinion that there should be more focus on enforcement and intervention.

The Committee supports the Court of Audit's resolution to conduct a prompt investigation of the functioning of DNB and advises them to follow this with a similar investigation of the AFM. The Committee further recommends including the aspects mentioned above in these investigations, that is to say supervisory culture, knowledge and expertise. Should it become apparent that the confidentiality provisions of the Financial Supervision Act will limit the Court of Audit in its investigation, the Committee recommends that the legislature take quick action to remove this obstacle.

Recommendation 26:

Adjust the liability of supervisory authorities

Fear of erroneous legal interpretations or damage claims should not be allowed to have an adverse effect on the policy choices of the Dutch financial supervisory authorities. The

Committee therefore recommends restricting the liability of the Dutch financial supervisory authorities and investigating ways to match usual practices at the European level.

Recommendation 27:

Improve the task of accountants

The primary expectation of the certified public accountants of financial institutions is that they perform a solid audit of the financial statements of financial institutions. This expectation is met only if both shareholders and other users of this financial information can be confident that the figures provide a reliable picture of the company. In the Committee's judgement, the financial crisis has shown that the accountancy profession fell short in its social duty to ensure a comprehensible and sufficient account of the financial health of financial institutions, particularly with regard to the reporting of uncertainty in the valuation of financial assets.

The Committee recommends that the professional association for accountants, together with the AFM, establish more detailed quality requirements that a financial institution's financial statements must meet. The goal is to make the financial statements of financial institutions provide as clearly as possible an image of all relevant conditions, including possible risks and uncertainties with regard to continuity. The Committee also recommends that the professional organisation and the AFM cooperate in taking measures to ensure that accountants make more frequent use of explanatory sections concerning situations of uncertainty in financial institutions.

The Committee underwrites and has expectations for the initiatives taken by the professional association to use the collective knowledge that is available for the early identification and monitoring of risks, problems and areas of attention within financial institutions as well as within the financial sector. The committee was interested to learn of the proposals for a new kind of tripartite conference (consultation between DNB, the financial company and the external accountant). These initiatives could contribute to restoring trust in accountants as reliable parties in the public sphere and the financial sector. The Committee sees no value in the suggestion to expand the duties of accountants to include other tasks in the area of corporate governance.

Illustrative case study:

Lessons for regulation and supervision

The Committee has selected two specific cases for more in-depth treatment in its inquiry. The first case involves events that occurred during the approval process and actual takeover of ABN AMRO in 2007. The second case involves events occurring around the introduction of Icesave in the Netherlands and the subsequent collapse of Landsbanki. The Committee is of the opinion that these cases can provide at least a partial illustration of the manner in which legislation and supervision regarding the financial system in the Netherlands functioned.

The case of ABN AMRO

The Committee has determined that, in the process surrounding the takeover of ABN AMRO, the Minister of Finance deliberately restricted unduly the policy space for making a stand-alone macro-prudential or system consideration regarding the issuance of a declaration of no objection in the takeover. This was partly inspired by the impending Antonveneta Directive. Because the future Directive appeared to leave no room for a broad interpretation of Criterion C, the Ministry presumed that the focus of the test should shift to Criteria A and B, the micro-prudential test. Only in extremely exceptional cases would the test for Criterion C return a negative result. One of the considerations for choosing this course of action was the European commotion surrounding the public statements made by the president of DNB during the early stages of the takeover process regarding the desirability of a takeover of ABN AMRO with the goal of breaking up ABN AMRO. Partly because of the media-political interest in the issuing process that these remarks generated, the Minister chose to fulfil his role in the issuing process in a limited manner, in order to prevent the appearance of political intervention nationally and in the European context.

The Committee has further established that the Ministry steered towards the issuance of a declaration of no objection. The Ministry was of the opinion that, as the legislation allowed the possibility of attaching conditions to such declarations, it was highly unlikely that it would not be issued. This assumption was also communicated clearly to DNB.

From the very beginning, DNB demonstrated in many ways its concerns about the consortium's plans to break up ABN AMRO after the takeover. In carrying out its main task in issuing the declaration of no objection, DNB allowed itself to be led by the assumption that the risks associated with takeover and break-up should be mitigated as much as possible. This was possible through such means as attaching conditions to the declaration of no objection. This arrangement led to a situation in which DNB closed any 'gaps' (to quote the president of DNB) that would have made it possible to say 'no' to the takeover.

The Committee concludes that the Minister and DNB, within the legal frameworks specified for issuing a declaration of no objection, deliberately opted for an arrangement that was highly likely to result in the issuance of a declaration of no objection for the takeover. The Minister also chose to shift the responsibility for a positive decision to DNB, proceeding from the assumption that a negative decision would be highly unlikely.

Rather than actively seizing the opportunity to assign a negative decision to the risks that were present, DNB chose to work intensively to mitigate these risks. Through this choice, DNB essentially assumed the responsibility for closing the gaps that would have allowed a negative judgement regarding the takeover and break-up.

In the Committee's judgement, the legal frameworks would have allowed the Minister of Finance and DNB to utilise the policy space that they had for carrying out their roles and responsibilities in the issuing of a declaration of no objection for the takeover of ABN AMRO in a manner other than the way that things actually occurred. If this space had been utilised in a different manner, the outcome of the issuance process of the declaration of no objection might have been different.

According to the Committee, examination of the case of ABN AMRO illustrates anew the complexity of the financial system and financial institutions. This complexity places high demands on policymakers and supervisory authorities in terms of the necessary knowledge, expertise, capacity and cooperation with international supervisory authorities. The case also illustrates that shared execution of the supervision of the financial system or sector by the Minister and DNB can lead to an ambiguous or awkward distribution of responsibility. In addition, the case confirms that systemic risks played a less important role in the policy and the supervisory activities preceding the financial crisis. The micro-prudential perspective also dominated in the evaluation of the application for the takeover and break-up of ABN AMRO.

The case of Icesave

The Committee wishes to emphasise that the core of the problems surrounding Icesave lay in the actions of Landsbanki and in the bearing of Iceland's Financial Supervisory Authority (FME).

The Committee has established that DNB was already well aware of the risks related to the Icelandic financial system, the Icelandic financial sector in general and Landsbanki in particular at an early stage, at the beginning of 2008. The Committee concludes that it was legally impossible for DNB to warn the public of these risks upon Landsbanki's introduction of Icesave on the Dutch market. Aside from the legal aspects, such a warning would have had the potential to cause serious damage to Landsbanki and the financial sector in Iceland.

In light of the risks that DNB recognised in connection with Iceland and Landsbanki, however, the Committee seriously questions the policy considerations that DNB made within the legal framework with regard to admitting Landsbanki to the Dutch deposit-guarantee scheme in May 2008. The Committee is of the opinion that DNB nonetheless could and should have imposed further conditions on the admission of Landsbanki. In the Committee's judgement, such actions would have been possible, as the Financial Supervision Act (Wft) offers the possibility of using a 'general administrative measure' (secondary legislation under Dutch law) to impose additional requirements. DNB could also have done so with reference to the ambiguities concerning the form and functioning of the deposit-guarantee scheme in Iceland.

The Committee concludes that DNB took an unduly narrow view of its authority to intervene in the Icesave case (by issuing a 'formal instruction'). Within the legal framework, the Financial Supervision Act (Wft) offers a certain level of policy freedom and judgement autonomy for issuing such instructions. In the case of Icesave, DNB chose not to make use of this freedom. The legal framework would have allowed a broader interpretation and a more pro-active stance and conduct on the part of DNB.

In the Committee's judgement, the Icesave case provides a shocking illustration of the problems that can arise within the European system of home-state control. In cases where problems emerge in specific financial institutions engaging in trans-national activities, national interests have proven to undermine the trust between supervisory authorities that is essential to this system.

The Committee is further of the opinion that the Icesave case clearly illustrates the divide that exists between the expectations that savers have with regard to supervision and the options that DNB has for warning savers. Formal options for DNB to inform savers of the risks associated with specific financial institutions are virtually non-existent.

Finally, the case also illustrates the manner in which the threat of a bank run and the possible assignment of liability and claims can affect the operations of a supervisory authority. In such a situation, it can be quite difficult for DNB to publicly apply formal measures, no matter how desirable such measures may be from the social perspective.