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SUBJECT European Banking Union

Dear Ms Van Miltenburg,

Introduction of the European banking union has regularly been a matter of debate in the House of Representatives. The new supervisory tasks that will be conferred on the European Central Bank (ECB) are of evident importance to the effective prudential supervision of credit institutions. The ECB will exercise its duties within the framework of the Single Supervisory Mechanism (SSM), which comprises both the ECB and the national competent authorities. The SSM is a response to the supervisory weaknesses revealed in the recent past and must contribute to the recovery of confidence in the banking sector. The ECB will supervise 128 significant banks in the euro area as from 4 November 2014. The national authorities will remain responsible for supervising the other banks, but in accordance with the supervisory framework established by the SSM.

Good supervision of credit institutions is of great importance to society. Care must be taken to ensure that the transfer of supervisory tasks from the member states to the EU is accompanied by a clear allocation of responsibilities and sound agreements on accountability for the supervision exercised. Structural opportunities for independent external control of supervision are also relevant in this respect. We draw your attention to this matter in this letter. The Minister of Finance is currently preparing a bill regarding the consequences of SSM for the tasks and powers of the Dutch central bank (DNB) when European bank supervision is introduced.

## 1 The European banking union

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The European Council of 18 October 2012 approved a 'roadmap towards a banking union'.<sup>1</sup> In the banking union, significant banks in the euro area member states will be subject to a single supervisory mechanism and the member states will be subject to uniform regulations, including a deposit guarantee scheme to protect account holders with banks in crisis. Table 1 summarises the regulations underlying the banking union and the building blocks that will form it.

Table 1. Legal basis and building blocks of the European banking union (as at 1 May 2014)

Legislation underpinning the banking union	Building blocks of the single rule book <sup>2</sup>		
	Bank capital requirements in the Capital Requirements Directive (CRD-IV) <sup>3</sup> and Capital Requirements Regulation (CRR) <sup>4</sup> . Relates to: EU28 Status: effective 20 July 2013	Bank recovery and resolution proposals in the Bank Recovery and Resolution Directive (BRRD) <sup>5</sup>  Relates to: EU28 Status: agreement between European Council, Commission and Parliament, 13 December 2013	Revised deposit guarantee scheme in the Deposit Guarantee Scheme Directive (DGSD) <sup>6</sup>  Relates to: EU28 Status: negotiation between the European Council and Parliament
Building blocks of the banking union	European Single Supervisory Mechanism ( <b>SSM</b> ) <sup>7</sup> . Relates to: euro area + other countries that want to participate Status: completed	Direct recapitalisation of banks by means of the European Stability Mechanism ( <b>ESM</b> ) <sup>8</sup> . Relates to: euro area Status: framework agreement Euro group 20 June 2013	European bank resolution mechanism: Single Resolution Mechanism ( <b>SRM</b> ) <sup>9</sup> Relates to: euro area + other countries that want to participate Status: approved by European Parliament at first reading, 15 April 2014.

<sup>1</sup> Communication from the European Commission to the European Parliament and the Council of 12 September 2012: A Roadmap towards a Banking Union, COM(2012) 510 final.

<sup>2</sup> The Single Rule Book is a set of harmonised rules, technical standards, etc. based on a Regulation for the uniform supervision of financial institutions in order to ensure the consistency of supervision. The standards laid down in the Regulation can be transposed directly into national law because the Regulation is binding in its entirety and directly applicable in all member states. The ECB and the European Banking Authority (EBA) must identify and eliminate all differences in national transposition mechanisms.

<sup>3</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

<sup>4</sup> Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

<sup>5</sup> COM(2012) 280 final of 6 June 2013, Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 77/91/EEC, and 82/891/EC, 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No. 1093/2010.

<sup>6</sup> COM(2010) 368 final of 12 July 2010, Proposal for a Directive.../.../EU of the European Parliament and of the Council on deposit guarantee schemes (recast).

<sup>7</sup> Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank relating to the prudential supervision of credit institutions. This Regulation came into effect on 4 November 2013. Actual implementation will commence a year later.

<sup>8</sup> ESM direct bank recapitalisation instrument. Main features of the operational framework and way forward, Eurogroup, Luxembourg 20 June 2013.

<sup>9</sup> COM(2013) 520 final of 10 July 2013, Proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No. 1093/2010 of the European Parliament and of the Council.

The SSM Regulation confers new tasks on the ECB to supervise the significant banks<sup>10</sup> in the euro area and significant banks in other EU member states participating in the SSM. The ECB will exercise these new powers as from 4 November 2014. In the meantime, the ECB and the European Banking Authority (EBA) are carrying out stress tests of the balance sheets of the significant banks that will be subject to the ECB's supervision.<sup>11</sup> In 2012, the 128 significant banks in the euro area that will be supervised by the ECB in the framework of the SSM together had total value of their assets of approximately €26,000 billion.<sup>12</sup>

The SRM Regulation will come into effect on 1 January 2016. It will introduce a uniform bank resolution mechanism. Under the SRM, the ECB must flag up banks subject to the SSM that are in such serious financial difficulties that they have to be resolved. A new to be established Single Resolution Board (SRB), or Resolution Authority (ECB, European Commission, relevant national resolution authorities), will prepare the resolution. Subject to the supervision of the SRB, national resolution authorities execute the resolution measures decided by the Board. The instruments the SRM can use are the sale of a bank, temporary transfer to a bridge bank, incorporation of a 'bad bank' and a creditor bail-in. In exceptional circumstances a new resolution fund can be mobilised. The fund will be financed by means of contributions from the banking sector in the participating member states over a period of ten years and will be equal to at least 1% of the deposits covered (approximately €55-60 billion).

The Eurogroup has not yet completed its decision-making on the *direct recapitalisation* of banks under the European Stability Mechanism (ESM) without the intervention of the government in the country in which the bank is located.<sup>13</sup>

## 2 Implications for supervision, accountability and control in the Netherlands

The Dutch central bank (DNB) currently has sole responsibility for the prudential supervision of Dutch banks. The Minister of Finance is responsible for the functioning of the system of prudential supervision as a whole and renders account to parliament. For supervisory purposes, he has access to confidential information necessary for the

<sup>10</sup> Significant banks are those with total value of its assets exceeds €30 billion.

<sup>11</sup> For a summary of the stress tests and the banks concerned, see <http://www.ecb.europa.eu/pub/pdf/other/notecomprehensiveassessment201310en.pdf>. The EBA published the stress test methodology and the implementation scenarios on 29 April 2014. The results of the stress tests and of the asset quality assessments will be published in October 2014.

<sup>12</sup> This is approximately 80% of the total assets of all banks in the euro area. Source: High-level Expert Group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, Final Report, Brussels, 2 October 2012, pp. 119-120.

<sup>13</sup> Indirect bank recapitalisation has been possible under the ESM since 2012. Banks in Spain and Cyprus have received €44.3 billion from the ESM for indirect recapitalisation. The ESM grants a loan to the member state that is added to the existing State debt.

stability of the financial system.<sup>14</sup> The Netherlands Court of Audit is currently mandated to exercise independent external control of supervision in the Netherlands.<sup>15</sup>

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The range of DNB's duties will change when the SSM comes into effect. Questions will be asked about the Minister of Finance's responsibility for supervising banks in the new situation and what options there will be for independent external control in the Netherlands.

It is still not entirely clear how the ECB will fulfil its new role, both as the central supervisor and as a supervisor working in conjunction with national supervisors. Prudential supervision of the significant banks will be transferred to the ECB. The ECB will also ensure that the other bank supervisors work within a harmonised framework. DNB will continue to supervise the less significant banks directly based on the supervisory framework of the SSM. If there is cause, the ECB can assume this supervision.

At issue is how the Minister of Finance will fulfil his responsibility for the national supervisory system as a whole and account to parliament within the framework of the SSM. The Minister will remain directly accountable for the functioning of the supervision of the less significant banks as long as they have not been placed under the ECB's supervision. Whether and to what extent the Minister remains responsible and accountable for supervision of significant Dutch banks after the ECB fully exercises the tasks conferred on it is uncertain at present.

As far as we can see at present, introduction of the SSM will restrict the Netherlands Court of Audit's ability to exercise independent external control of the functioning of supervision in the Netherlands. In other words, the Court will no longer be able to audit the functioning of supervision of significant Dutch banks. This supervision will in the future be exercised by the ECB, and the Court cannot audit the ECB. It seems that the new powers conferred on the Court on 13 May 2014, including public reporting to parliament, will be limited to supervising the less significant Dutch banks.<sup>16</sup>

The Minister of Finance has said that the government will work within the frameworks of the new European rules to ensure that the Court can continue to access information on

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<sup>14</sup> See Bulletin of Act and Decrees, 2013, 487, Act of 25 November 2013 amending the Financial Supervision Act.

<sup>15</sup> The Court of Audit's general mandate is laid down in the Government Accounts Act. The recent amendment of the Act on Financial Supervision (WFT) related to the provision of confidential data or information by the Dutch central bank (DNB) and the Authority for the Financial Markets (AFM) to the Court of Audit. See the Minister of Finance's letter to the House of Representatives of 12 September 2013 regarding the proposal to amend the Financial Supervision Act for the provision of confidential data or information by the Dutch central bank (DNB) and the Authority for the Financial Markets (AFM) to the Court of Audit.

<sup>16</sup> The Senate approved the amendment of the WFT on 13 May 2014.

significant banks from DNB.<sup>17</sup> According to the Minister, the Court's powers will be influenced by the audit powers conferred on the European Court of Auditors (ECA) in this area and whether its audit system in combination with those of the national audit institutions forms a comprehensive system.<sup>18</sup> It is still uncertain how tasks will be assigned to the ECA and the Netherlands Court of Audit (and to the audit institutions in the other member states). The Minister of Finance is currently preparing a bill to regulate the consequences of the SSM for the tasks, scope and powers of DNB and European bank supervision.

The introduction of the SRM will – as far as we can tell now, and it does not concern Dutch banks – have no direct consequences for supervision and control in the Netherlands. The following section considers the implications of banking union for supervision and control at EU level.

### **3 Implications for supervision, accountability and control in Europe**

#### **3.1 Bank supervision: Single Supervisory Mechanism**

On the introduction of the SSM, the ECB will be exclusively responsible for the supervision of significant banks. Its position is worked out in the Interinstitutional Agreement (IIA) of 4 November 2013 between the European Parliament and the ECB.<sup>19</sup> The ECB will submit a report to the European Parliament each year on its exercise of the tasks conferred on it by the Regulation. The chair of the supervisory board,<sup>20</sup> that will exercise the ECB's supervisory tasks and prepares draft decisions for the approval of the ECB's governing council, presents the report at a public hearing of the European Parliament. If necessary, the European Parliament can appoint a temporary inquiry committee. The ECB must cooperate in full with the committee. The IIA does not apply to the exchange of confidential information on monetary policy or to other tasks of the ECB that the Regulation has not conferred on it. Under the IIA, the national competent authorities' accountability to their own parliaments remains a matter of national law.

The ECA's regular audits of the ECB examine the operational efficiency of the ECB's management. SSM Regulation (EU) no. 1024/2013 stipulates that the ECA's activities

<sup>17</sup> See the memorandum further to the Report on the Amendment of the Act on Financial Supervision regarding DNB and AFM's provision of confidential data or information to the Court of Audit, House of Representatives, 2013-2014, 33 729, no. 6.

<sup>18</sup> Legislative consultation on the amendment of the WFT of 23 April 2014.

<sup>19</sup> Interinstitutional Agreement between the European Parliament and the European Central Bank on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the Single Supervisory Mechanism. (2013/694/EU), Official Journal of the European Union, L 320/1.

<sup>20</sup> The chair is currently held by Danièle Nouy.

shall take account of the supervisory tasks conferred on the ECB.<sup>21</sup> This means that the SSM does not confer any new specific tasks on the ECA to examine the functioning of the ECB's supervision.<sup>22</sup> As far as we can tell, national audit institutions will lose the access they had to the supervisory files of individual significant banks in their country, but it is uncertain whether the ECA can assume these activities in its audits of the ECB. This will lead to a deterioration in independent external control in these countries: an audit gap. In other countries, where the national audit institution is not mandated to audit supervision of the banking sector at national level, there already is an audit gap.

### 3.2 *Direct bank recapitalisation: ESM*

The permanent rescue mechanism, ESM, is an intergovernmental organisation incorporated under international law. The by-laws of the ESM treaty lay down that independent external control of the ESM's activities, which focused in 2012 and 2013 on *indirect* bank support to Cyprus and Spain, will be exercised by an independent Board of Auditors comprising five members. The Eurogroup's declaration of 20 June 2013 on *direct* bank support from the ESM states that the ESM Board of Governors and Board of Directors will receive all relevant information necessary for them to exercise their tasks. It does not refer to the ESM Board of Auditors. Nevertheless, it is thought that this new instrument will be audited by the ESM Board of Auditors after the Board of Governors has added it to the list of instruments to be used by the ESM.

### 3.3 *Bank resolution: Single Resolution Mechanism*

The SRM is a common resolution mechanism for banks. The SRM agreement refers to opportunities for independent external control by the ECA in several places.

- The ECA reviews the provisional accounts of the Resolution Authority.
- To combat fraud, the ECA can audit the documents and carry out on the spot audits of all beneficiaries, contractors and subcontractors who receive funds from the Union's Resolution Authority.

The report of the Eurogroup and Ecofin Council of 17 and 18 December 2013,<sup>23</sup> which the Minister of Finance has sent to the House of Representatives, also states that the ECA will publish a report every 12 months on the efficiency and effectiveness of the

<sup>21</sup> Regulation (EU) No. 1024/2013 of the Council lays down, 'when the European Court of Audit examines the operational efficiency of the management of the ECB under Article 27.2 of the Statute of the ESCB and of the ECB, it shall also take into account the supervisory tasks conferred on the ECB by this Regulation'.

<sup>22</sup> In his statement of 7 February 2013, the President of the ECA said that the treaty protocol on operational efficiency extended the scope of the ECA's powers to the sound financial management of the supervisory powers conferred on the ECB.

<sup>23</sup> Letter from the Minister of Finance to the President of the House of Representatives of the States General of 19 December 2013, 'Report of the Eurogroup and Ecofin Council in Brussels on 17 and 18 December 2013'.

European Resolution Authority. The ECA's scope to audit the SRM in this respect is still uncertain.

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#### **4 Recommendations**

On the basis of the above, we recommend that the Minister of Finance:

- Work within the EU to agree upon a broad mandate for ECA (regularity, efficiency, effectiveness) for independent external control of the ECB's supervision so that the supervision and control system in place for the SSM is comprehensive at EU level. The mandate should permit unrestricted access to all supervisory files, the exchange of information with national audit institutions and wide publication opportunities.
- Clarify what his ministerial responsibility will entail for the supervision of significant banks after introduction of the SSM in the Netherlands, the opportunities for independent external control of DNB's supervision and what information on the banks subject to the ECB's supervision will still be available to the Netherlands Court of Audit.
- Work within the ESM Board of Governors to ensure that the ESM Board of Auditors has access to the resources necessary for it to carry out all its audit activities, with a view in part to the ESM's wider tasks.
- In agreement with the EU institutions concerned, clarify how the ECA will be able to audit the European Resolution Authority, and clarify the apparent agreement that the ECA will publish a report on the effectiveness and efficiency of the Resolution Authority every 12 months.

#### **5 Response of the Minister of Finance and the Court of Audit's afterword**

We sent a draft of this letter to the Minister of Finance on 5 June 2014 and received his response on 30 June 2014.

In response to our recommendation that the supervisory and control system in place for the SSM be comprehensive at EU level, the Minister wrote that he was aware that the ECA's current mandate and the powers conferred on it might be inadequate for it to control the ECB's bank supervision to the same standard that the Netherlands Court of Audit audits DNB. He will work within the EU to have the ECA be given the powers necessary to audit the ECB's supervisory tasks adequately.

In response to our recommendation that he clarify what ministerial responsibility for the supervision of significant banks will entail after introduction of the SSM in

the Netherlands and what the opportunities for independent external control will be, the Minister wrote that ministerial responsibility for the supervision exercised by, under the responsibility of or on the instruction of the ECB in the framework of the SSM would be restricted. He also observed that the SSM Regulation stipulates that the ECB can exchange information with national institutions such as the Court of Audit.

Regarding our recommendation that he works within the ESM Board of Governors to ensure that the ESM audit committee has access to the resources it needs to carry out all its audit activities, with a view in part to the new ESM instrument for direct bank recapitalisation, the Minister wrote that he had received no signals that problems would occur in this area.

Finally, regarding our recommendation that he clarify the ECA's intended power to audit the European Resolution Authority and the agreement that the ECA will publish a report on the Resolution Authority's effectiveness and efficiency every 12 months, the Minister provided an overview of the ECA's intended powers to audit the European Resolution Authority.

*Court of Audit's afterword*

We appreciate the Minister's clarification that (1) the ECA's current mandate might be inadequate to audit the ECB's bank supervision adequately, and (2) that ministerial responsibility will be restricted by the supervision of both significant and less significant banks exercised in the framework of the SSM. We wonder where the democratic responsibility for the supervision exercised by the ECB will be placed. We are pleased that the Minister will work within the EU to have the ECA be given adequate powers to audit the ECB's supervisory tasks. We will follow developments with interest.

We will send copies of this letter to the President of the Senate and to the Minister of Finance.

Netherlands Court of Audit

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