Algemene Rekenkamer

Mitigation of DNB's Financial Risks

The Role of the Minister of Finance

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Executive Summary

Monetary policy of the European Central Bank and mitigation of DNB's financial risks

Measures taken by the European Central Bank (ECB) to stimulate the eurozone economy in recent years have steadily increased the ECB's debt portfolio and exposed it to additional financial risks. The monetary policy conducted jointly by the ECB and the national central banks of the euro countries has also exposed the Dutch Central bank (DNB) to financial risks. This report considers the measures taken to mitigate those risks and the role played by the Dutch Minister of Finance.

The risks facing DNB arise primarily from the ECB's programmes of purchasing government and corporate bonds in order to stimulate the economy and increase the rate of inflation towards 2%. To mitigate the risks attaching to the ECB's purchase programmes, DNB is forming a *provision*. Doing so is at the expense of the bank's profit distribution to the State, DNB's sole shareholder.

DNB is also exposed to the risks resulting from the support programme the ECB provided to the euro countries that were previously in crisis: Greece, Portugal and Cyprus. To cover these risks, the State provided DNB with a € 5.7 billion *guarantee* between 1 March 2013 and 1 March 2018.

Our audit

In the first half of 2018, the Netherlands Court of Audit audited the Minister of Finance's involvement in the provision and the guarantee. We looked at how the minister had dealt with a number of dilemmas. The first concerned DNB's independence to carry out monetary tasks and the Minister of Finance's role as its shareholder on behalf of the State. The second concerned the conflict between the State's short-term interests (profit distribution) and its long-term interests (financial robustness) as shareholder.

Conclusions

Our audit shows that the Minister of Finance's relationship to DNB and the mitigation of its monetary policy risks was not entirely clear as a result of the many laws and regulations applicable and laid down in, for example, Book 2 of the Dutch Civil Code, the Bank Act, DNB's articles of association, the Treaty on the Functioning of the European Union, the Financial Supervision Act and the Policy Document on State Owned Enterprises 2013.
As shareholder, the State must observe company law and Book 2 of the Dutch Civil Code in particular. However, there are exceptions, some of them specifically mentioned in the

Bank Act. It is accordingly difficult to establish what can be expected of the minister in any given situation.

Our audit also shows that the Minister of Finance critically and constructively followed the way in which DNB dealt with monetary policy risks that affected the State's financial interests.

Finally, we found that the preparations for a decision on the provision and the guarantee did not take verifiable account of the State's conflicting interests as DNB's shareholder. Both the decision to give DNB a guarantee in 2013 and the decision to allow DNB to form a provision in 2016 were based mainly on the ministry's short-term interests: the impact on DNB's profit distribution to the State.

Recommendations

We recommend that the Minister of Finance defines and documents his relationship to DNB and its mitigation of monetary policy risks in the manner that the agreements on DNB's tasks as an autonomous administrative authority have been documented in the Policy Document on Remote Supervision. Such a document could explain what legal provisions apply and what information should be exchanged between DNB and the Minister of Finance and between the Minister of Finance and the House of Representatives.

We further recommend that, in accordance with the 2013 Policy Document on State Owned Enterprises, the ministry's preparations for decision-making pay more specific attention to the State's conflicting interests that the minister must take into account.

Response of the Minister of Finance

The Minister of Finance provides an explanation of DNB's legal form, the State's shareholdership and DNB's position as part of the European System of Central Banks. In that manner he follows up the recommendation to define and document his relationship to DNB as shareholder and to clarify which legal provisions are applicable. Regarding the exchange of information between DNB and the Minister of Finance, he refers to a provision in the Bank Act 1998 on the exchange of information on DNB's tasks and activities. Regarding the provision of information to the House of Representatives, the minister refers to the ECB's annual report, DNB's annual report and his meetings on request with the president of DNB.

The minister agrees with our recommendation that preparations for decision-making on DNB's risk exposure and profit distributions should make a clear distinction between the interests of the shareholder and those of the guardian of the public purse.

The Court of Audit's afterword

The Minister of Finance's response is a step towards clarifying his relationship as shareholder of DNB with regard to its implementation of the monetary tasks. The minister's explanation shows that the relationship between DNB and the Minister of Finance may appear to be one between two parties but in reality it embraces several formal roles, tasks and powers, each having a different relationship with the others. The description would be more persuasive if the minister had specifically stated what information he needed in his capacity as shareholder and what in his capacity as guardian of the public purse.

We recognise the importance of having an orderly decision-making process regarding DNB's capital policy, with specific insight being provided into the minister's interests in his varying roles, and will follow developments with interest.

1 Introduction

1.1 Unconventional measures taken by the European Central Bank

Between 2010 and 2012, the European Central Bank (ECB) purchased government bonds issued by eurozone member states that had the greatest liquidity requirements (ECB, 2010). As from the end of 2011, it also extended credit to banks in Greece, Cyprus and Portugal (ECB, 2011a and ECB, 2011b). These measures became known as crisis-related measures.[1]

At the end of 2014, when the economic crisis was beginning to recede, the ECB decided to stimulate the economy in the eurozone[2] by increasing money supply (ECB, 2014). It decided to intervene because of the exceptionally low rate of inflation in the eurozone. Low inflation, or even deflation (entailing a reduction in prices), is seen as a sign of economic stagnation. Consumers are less inclined to spend, wages remain static and companies are unable to increase their prices.

The ECB wanted to increase inflation. One of its goals is to maintain the average annual rate of inflation in the eurozone below but close to 2% (ECB, 2011c). This goal is based on the ECB's statutory task of maintaining price stability (article 127, paragraph 1 of the EU Treaty[3]). The ECB was prompted to intervene by a 0.2% average fall in price levels in December 2014. It accordingly embarked on a large scale programme to purchase government bonds issued by euro countries; after 2016 it also purchased corporate bonds.[4]

Impact of the ECB's purchase programme

In theory, financial institutions that invest in government bonds issued by euro governments receive 'fresh money' if the ECB purchases the bonds and so enables them to grant new loans to companies and consumers. The ECB's purchase programme therefore indirectly provided new, inexpensive credit to stimulate the economy.

As a result of the ECB's monetary policy, its debt portfolio has steadily increased since 2015 and the ECB is exposed to a financial risk (DNB, 2016). The ECB has purchased long-term bonds and loans from credit institutions on which it receives a low rate of interest. The same credit institutions deposit their surplus funds with the ECB, which in turn pays interest on the deposits. If the ECB raises the current extremely low rates of interest at some point in the future, it will suffer a loss on the bonds because it will then be paying a higher rate of interest to the credit institutions than it receives on the bonds and loans it has purchased. In addition to this interest rate risk, the ECB is exposed to a credit risk. Credit risk is the risk that the bond issuers (national governments, European institutions and companies) default on their redemption obligations. If they cannot redeem the bonds, the ECB will have to write them off and incur a loss.

1.2 Risks to DNB

The ECB is the central bank of the euro countries. The ECB and the euro countries' national central banks together form the Eurosystem. As a member of the Eurosystem, DNB is also exposed to the risks arising from the ECB's purchase programme.

In comparison with other national central banks, DNB is running a higher interest rate risk but a lower credit risk (DNB, 2016). This is because most (80%) of the bonds bought up are Dutch government bonds. The credit risk on such sovereign debt is not shared among the euro countries' national central banks but is borne entirely by the central bank of the country concerned. The credit risk on institutional and corporate bonds and loans, by contrast, is shared among the national central banks. Dutch government bonds, where all the risk is borne by DNB, are very creditworthy (i.e. they have a low credit risk) and accordingly bear a low rate of interest (i.e. they have a high interest rate risk).

DNB has been forming a provision to cover these risks since 2016. It was thought at the time that a provision of € 2.7 billion would be sufficient. It is being formed by means of annual tranches of € 500 million that are deducted from the profit distributed to the State of the Netherlands. In March 2018, the provision amounted to € 1.5 billion (DNB, 2018). The provision is on top of DNB's regular capital buffer, which totalled € 7.9 billion at the end of 2017. In addition, the State gave DNB a guarantee of € 5.7 billion between 1 March 2013 and 1 March 2018 in order to cover the risks of the support package the ECB provided to help Greece, Portugal and Cyprus overcome the financial crisis.

1.3 Role of the Minister of Finance

The Minister of Finance is not involved in decision-making on the risks DNB faces as a result of the ECB's monetary policy. DNB's independence to set monetary policy is laid down in the Treaty on the Functioning of the European Union (TFEU) and in the statute of the European System of Central Banks (ESCB).[5] How DNB mitigates monetary policy risks has consequences for its own balance sheet, financial stability and public finances. There are therefore consequences for the Minister of Finance in his capacity as the shareholder of DNB on behalf of the State and in his capacity as the minister responsible for financial stability. The State, after all, is the ultimate guarantor should DNB's capital and reserves prove inadequate.

Under company law, the Minister of Finance has certain rights and powers as shareholder of DNB. In our report, The State as Public Shareholder (Netherlands Court of Audit, 2015), we wrote the following.

Rights and powers of the State as a shareholder

The State holds shares in a company in order to influence its business performance and so – as a supplement to legislation and regulation – protect the public interest. Shareholdership is a civil-law management instrument that company law offers to shareholders. The State is subject to company law as a shareholder. The public interest must therefore be protected by means of the instruments provided by company law and the State can exercise the powers that company law confers on the general meeting of shareholders. Shareholders can exercise certain powers available under company law only if they are specifically laid down in the company's articles of association.

The Minister of Finance's exercise of his shareholder rights of DNB is also subject to the provisions of the TFEU, the ESCB's statute, the Bank Act and the Financial Supervision Act (WFT).

As shareholder of DNB, the minister approves the annual accounts adopted by DNB's Governing Board. It is in his interest that the central bank operates efficiently and like all other central banks in the euro countries maintains adequate buffers.[6] But the minister also considers the direct consequences that DNB's policy proposals, decisions and actions have for the profit distribution and thus the revenue for the national budget. There is a conflict of interest here: DNB's creation of buffers is at the expense of the profit distribution and can therefore be a cause of lost revenue for the national budget.

1.4 Our audit

The Netherlands Court of Audit audited the role played by the Minister of Finance in the mitigation of DNB's risks arising from the ECB's monetary policy. On the basis of the decisions taken on the guarantee provided as from 2013 and DNB's decision in 2016 to form a provision, we examined:

- the policy pursued by the Minister of Finance in his role as shareholder of DNB and how he took the conflicting interests at play into account;

- the information available to the Minister of Finance to fulfil his role as shareholder of DNB;
- how the minister assessed this information in the light of the conflicting different interests.

As noted above, DNB carries out its monetary policy completely independently. The Court of Audit has no mandate to audit DNB's execution of the tasks laid down in the TFEU. They are specifically exempted from audit under section 7.25 of the Government Accounts Act 2016. We therefore did not audit whether the provision formed by DNB adequately mitigated the risks of the ECB's monetary policy.

Audit of DNB's tasks

This audit focused on the Minister of Finance's role in mitigating the risks DNB is exposed to on account of its monetary tasks. Apart from its monetary tasks, DNB also carries out:

- tasks as an autonomous administrative authority, such as the supervision of financial institutions, the resolution and restructuring of failing banks and the implementation of the deposit guarantee scheme;
- other national tasks as a central bank, including the promotion of a safe and reliable payment system and the collection of statistical information.

The relationship between the Minister of Finance and DNB differs for each of these statutory tasks. The relationship for DNB's tasks as an autonomous administrative authority is regulated by the Autonomous Administrative Authority Framework Act, the Financial Supervision Act (WFT) and the Bank Act. Regarding the other tasks, the powers the Minister of Finance can exercise as a shareholder are laid down ,in the context of ESCB, in Book 2 of the Dutch Civil Code, the Bank Act and the WFT.

Previous audits of DNB by the Court of Audit

The Minister of Finance's role at DNB has been the subject of several of our audits in the past. In The State as Public Shareholder (Netherlands Court of Audit, 2015), we looked at how the State exercised its shareholder powers at State owned enterprises. In Supervision of Banks in the Netherlands (Netherlands Court of Audit, 2017), we presented the findings of our audit of DNB's supervision of medium-sized and small banks and the Minister of Finance's supervision of DNB's bank supervision. In Financial Risks to the Netherlands of International Guarantees (Netherlands Court of Audit, 2013), we investigated the relation-ship between the Netherlands and eight international financial institutions, the financial risks to the Netherlands and the measures taken by the institutions to reduce them. One of the institutions was the Eurosystem formed by the ECB and the national central banks of the euro countries.

1.5 Structure of this report

This report first looks at the measures taken by DNB and the State between 2013 and 2017 to mitigate DNB's financial risks and how the size of those risks was estimated (chapter 2). We then outline how the Minister of Finance assessed DNB's plans during that period and, more generally, consider the minister's relationship to DNB and its monetary tasks (chapter 3). We then look at the different interests and the way in which the Minister of Finance fulfilled his role in respect of DNB (chapter 4). We close by discussing the minister's response to our draft report and presenting our afterword (chapter 5).

2 DNB's risk policy and risk models

To mitigate DNB's exposure to the ECB's monetary policy, the State of the Netherlands provided DNB with a guarantee in 2013. The bank also strengthened its own buffers by forming a risk provision as from 2016 (section 2.1). At the end of that year, however, an evaluation of its risk models concluded that DNB had overestimated the risks (section 2.2). DNB's capital policy is currently being assessed jointly by the Ministry of Finance and DNB (section 2.3).

2.1 DNB's risk policy

DNB's exposure to financial risks is the outcome of two factors: 1) its own investments, and 2) the ECB's monetary policy. DNB has only limited influence over the latter as the ECB's monetary policy is agreed jointly by the ECB and the national central banks of the countries that have introduced the euro (the Eurosystem). As a rule, DNB's financial buffers provide a relatively high level of assurance (99%) regarding the financial risks it runs. The moment they do not, however, measures have to be taken. This was the case in 2013, when the State of the Netherlands provided DNB with a guarantee.

Guarantee

At the end of 2012 DNB calculated its financial risk exposure at € 13.5 billion. The bank had buffers of € 7.8 billion at the time. This imbalance had arisen on account of the support package the ECB had introduced to assist euro countries in crisis and thus stabilise the eurozone.
To cover the shortfall in the buffers, on 1 March 2013 the State decided to provide DNB with a guarantee of € 5.7 billion for a period of five years.[7] In February 2018, the minister informed the House of Representatives that it would not be necessary to renew the guarantee because DNB's buffers were now adequate (Ministry of Finance, 2018).

In 2016, DNB decided to form an additional provision to cover its exposure to the ECB's purchase programmes. This decision had consequences for DNB's 2015 profit distribution to its shareholder, the State of the Netherlands. This can be seen in DNB's annual report for 2015: the profit distribution to the State is € 500 million lower and € 500 million has been added to the provision. The provision's overall requirement at the end of 2016 was estimated at € 2.7 billion.

Provision

Under an agreement signed in 1998, DNB adds 5% of its annual profit to its reserves and distributes the remaining 95% to the State. In January 2016, DNB informed the Minister of Finance that it wished to form a provision. The provision was necessary to cover the risks arising from the ECB's extension of its purchase programme. Forming the provision would have consequences for the profit distribution to the State for 2015 and subsequent years. At the time, DNB thought the provision would require € 3.8 billion, which would be formed by means of annual tranches of € 500 million.
Following DNB's annual general meeting on 23 March 2016, the Minister of Finance informed the House of Representatives that DNB would distribute less profit on account of the risk provision (Ministry of Finance, 2016a). At the end of 2016 the estimate of the required provision was adjusted downwards to € 2.7 billion (Ministry of Finance, 2016b). In July 2018 the provision amounted to € 1.5 billion.

Table 1 shows DNB's risks and buffers. The € 5.7 billion State guarantee given in 2013 to cover the risks arising from the support measures for Greece, Portugal and Cyprus is not shown as a buffer because it is not a capital buffer held by DNB itself.

It can be seen from table 1 that without the State guarantee DNB's buffer would have been inadequate between 2012 and 2016. The buffers were considerably lower than the amounts at risk. At the end of 2017 DNB's buffers were high enough to cover all risks, including those covered by the guarantee. The guarantee was therefore not renewed when it expired on 1 March 2018.

Table 1 *DNB's risks and buffers 2012-2017 (in billions of euros)*

	2012	2013	2014	2015	2016	2017
Total risk	**13.5**	**11.2**	**9.3**	**12.7**	**10.5**	**8.4**
Risks provided for (ECB purchase programme)	*	*	0.1	2.4	3.7	3.6
Risks guaranteed by the State (support measures for crisis countries)	*	*	7.0	8.1	5.4	3.5
Risks of DNB's own investments and other assets	*	*	2.2	2.2	1.4	1.3
Total buffers	**7.8**	**7.8**	**7.9**	**8.4**	**8.9**	**9.4**
Capital and reserves			7.9	7.9	7.9	7.9
Provision				0.5	1.0	1.5

** DNB's annual reports for 2012 and 2013 do not specify the risks.*

Source: DNB's annual reports 2012-2017; situation as at 31 December of each year.

2.2 Risk models[8]

DNB uses its own risk models to calculate financial risks. The Minister of Finance is not involved in the models' formulation, either as a shareholder or as a policy maker. The risk models are underpinned by a comprehensive quality system. They are evaluated every year by internal experts (including DNB's supervision department) and external specialists (including the external auditor) and revised where necessary.

In June 2016 DNB informed the Ministry of Finance that the risk models had been evaluated and an input error had been found. DNB's exposure to the crisis measures (which was covered by the State guarantee) had been overestimated by € 1.8 billion. According to the Minister of Finance, the input error did not need to be disclosed in the 2017 Budget Memorandum because the Budget Memorandum does not consider current risks. Under the Central Government Budget Regulations, he formally did not need to disclose the input error.[9] At the end of August 2016, the minister decided not to inform the House of Representatives separately of the input error. We do not know how or why the minister came to this decision.

The Minister of Finance informed the House of Representatives of the risk models' evaluation by letter of 1 December 2016 (Ministry of Finance, 2016b). He enclosed a letter from DNB of 22 November 2016 informing the minister of the outcome of the evaluation. The evaluation reduced the exposure to the crisis measures, which was covered by the State guarantee, from € 8.1 billion to € 5.7 billion as at the end of 2016. DNB's exposure to the ECB's purchase programme was also lower than initially estimated and the provision could be adjusted downwards from € 3.8 billion to € 2.7 billion. The letter from DNB of 22 November 2016 revealed that the adjustments were due to 'corrections, updated parameters and the harmonisation of calculations in order to bring them into line with their accounting treatment' (DNB, 2016). The letter did not refer specifically to the input error, nor did it state the amount by which the guaranteed exposure had been adjusted. Furthermore, the letter contained no details on the amount by which the provision for the purchase programme had been adjusted.[10]

2.3 Working group on DNB's capital policy

The Minister of Finance and DNB established a working group in early 2018 to analyse DNB's working capital policy. It will study alternatives to the current agreement under which DNB distributes 95% of its profit to the State and adds the remaining 5% to its general reserves.

3 The Minister of Finance's relationship to DNB

The Ministry of Finance critically and constructively assessed DNB's plans to mitigate monetary policy risks in 2013-2016 (section 3.1). The Minister of Finance's relationship to DNB and the mitigation of its monetary policy risks is not yet laid down in policy. It is consequently not certain what information he requires as the shareholder of DNB and what information he needs in order to render account to the House of Representatives (section 3.2).

3.1 2013–2016: the minister's assessment of DNB's intentions

Given the public importance of DNB's tasks, there is close contact between DNB and the Ministry of Finance, both at senior management level, between the minister and DNB's president, and at civil service level, between the ministry's officials and DNB's officials.

In 2013 there was high level contact between the minister and DNB to discuss how DNB's exposure to the ECB's monetary policy (see chapter 2) could be mitigated. Several alternatives were proposed.

To mitigate the financial risks resulting from the support provided to crisis countries, DNB was allowed to form a provision in accordance with a guideline issued by the ECB (ECB, 2012). Following consultation, however, it was decided that the State would give a guarantee. One of the minister's main reasons for this was that a guarantee would not lead directly to a reduction in the profit distribution to the State during a period of budgetary pressure (Ministry of Finance, 2013a).
During the preparations for DNB's 2016 decision to form a provision to mitigate the risks of the ECB's purchase programme, the Minister of Finance considered offering a guarantee as a temporary alternative, as it would have no adverse consequences for the distribution to the State. In the end, this alternative was rejected.

Our audit shows that officials at the Ministry of Finance closely followed the risks covered by the 2013 guarantee (i.e. the support measures for crisis countries) and informed the minister of their development. Ministry officials compared the information they periodically received from DNB with their own calculations and consulted DNB where necessary.

Officials from the ministry and DNB held several meetings about the evaluation of the risk models and consider the input error referred to in chapter 2. Following DNB's revision of its risk models, officials from the ministry investigated whether the models had been improved and whether their suggestions had been acted upon. Officials from the ministry also determined what effect the revised models would have on DNB's buffers and informed the minister of their findings.

We conclude that the Ministry of Finance was closely involved in DNB's proposals to mitigate monetary policy risks between 2013 and 2016. The ministry critically and constructively assessed the information provided to it by DNB.

3.2 Future relationship between the Minister of Finance and DNB

The developments described above are indicative of the tension between DNB's independence to implement monetary tasks on the one hand and the Minister of Finance's responsibility for DNB on the other. The Minister of Finance's future relationship with DNB and the mitigation of its monetary policy risks is therefore relevant.

Both the ECB's support for the crisis countries and its purchase programme exposed DNB to monetary policy risks. The governments and parliaments of the individual euro countries are not involved in the risks their central banks enter into. What does this mean for the relationship between the Minister of Finance and DNB?

The minister's responsibilities for DNB's tasks as an autonomous administrative authority (its supervision of financial institutions, resolution and restructuring of failing banks and implementation of the deposit guarantee scheme) are laid down in the Autonomous Administrative Authorities Framework Act and are further elaborated upon in the Policy Document on Remote Supervision (Ministry of Finance, 2011).[11]

The minister's responsibilities for DNB's monetary and other national tasks, however, have not been documented. It is difficult to establish precisely what can be expected of the Minister of Finance in any given situation owing to the many laws and regulations. They include Book 2 of the Dutch Civil Code, the Bank Act, DNB's articles of association, the TFEU, the WFT and the Policy Document on State Owned Enterprises 2013 (Ministry of Finance, 2013). All these documents contain provisions applying to the relationship between the minister and DNB.[12]

The minister's relationship as shareholder to DNB and the mitigation of its monetary policy risks is therefore not entirely clear. This has a bearing on the consultations between the minister and the president of DNB and on the official preparations for them. The relationship should be clarified, not least with a view to the provision of information to the House of Representatives.

Recommendation

In the light of the above and the agreements set out in the Policy Document on Remote Supervision regarding DNB's tasks as an autonomous administrative authority, we recommend that the Minister of Finance document his shareholder relationship to DNB and state what legal provisions are applicable under company law, the Bank Act and the WFT. Agreements should also be made on the exchange of information between DNB and the Minister of Finance and between the Minister of Finance and the House of Representatives.

4 Intertwining interests in decision-making on DNB

The Minister of Finance's policy decisions on state owned enterprises must take specific account of any conflicts of interest (section 4.1). In the case of DNB, no verifiable account was taken of conflicting interests ahead of the ministry's decisions in 2013 and 2016. We recommend that the minister take account of them in the future (section 4.2).

4.1 Policy on state owned enterprises: separation of roles

Where the State is a shareholder in an enterprise, the various roles performed by the government must be very clearly separated. This is laid down in the Ministry of Finance's Policy Document on State Owned Enterprises 2013.

The roles the government carries out at State owned enterprises (those of policy maker on the one hand and as shareholder and financial stakeholder on the other) can lead to a conflict of interest. Identifying the conflicts, according to the policy document, reveals the pros and cons of alternative policy decisions. 'This clarifies the final considerations, which in turn leads to better decision-making' (Ministry of Finance, 2013b, p. 36).

For these reasons, the policy document argues that State ownership should be centralised wherever possible. The management of state owned enterprises has accordingly been transferred to the Ministry of Finance; the line ministries are responsible for policy. If policy and management are closely intertwined, however, the two roles (policy and management) are carried out by one and the same ministry. This is the case with DNB (Ministry of Finance, 2013b, p. 38). Nevertheless, conflicts between the advisory and decision-making interests in such cases must be clearly resolved. The policy document stresses 'that weighing the different interests should be done in an orderly and structured manner' (Ministry of Finance, 2013b, p. 36).

4.2 No verifiable consideration of intertwining interest in decision-making on mitigation of DNB's risks

Our audit shows that the preparatory talks on DNB's mitigation of financial risks did not specifically identify or verifiably consider the State's various interests, as urged in the Policy Document on State Owned Enterprises 2013. In both the 2013 decision to provide a guarantee and the 2016 decision on DNB's formation of a provision, the ministry referred principally to the consequences for DNB's profit distribution to the State:

- in 2013 the Minister of Finance decided to give a guarantee in order to maintain the profit distribution to the State;
- in 2016, too, the Minister of Finance considered giving a temporary guarantee for the same reason, but ultimately decided not to.

In brief, the different interests were clearly present during decision-making on the provision of a guarantee and the formation of a reserve. The Ministry of Finance’s preparations for decision-making, however, did not specifically explain what interests were at play and how they should be dealt with. Different decisions are taken in different circumstances but in our opinion preparations for decision-making should specifically consider all the interests concerned.

Recommendation
We recommend that, in accordance with the principles of the Policy Document on State Owned Enterprises 2013, the Ministry of Finance’s decisions on mitigation of DNB’s monetary policy risks should make a clearer distinction between the minister’s various responsibilities and interests.

5 Response of the minister and the Court of Audit's afterword

The Minister of Finance responded to our report on 12 December 2018. His letter is summarised below and presented in full (in Dutch) at www.rekenkamer.nl. We close this chapter with our afterword.

5.1 Response of the Minister of Finance

The minister welcomes our conclusion that he had critically and constructively followed the way in which DNB had dealt with its exposure to monetary policy risks that affect the public purse.

The minister provides a detailed explanation of his general relationship to DNB. It is based on DNB's monetary tasks and various other tasks, including those as supervisor of financial institutions. The minister then consideres DNB's legal form, the consequences for the State's shareholdership and DNB's membership of the ESCB. He states that in this manner he follows up the Court of Audit's recommendation that he should document his shareholder relationship to DNB and clarify what legal provisions are applicable, in the same way that his relationship to DNB as an autonomous administrative authority is laid down in the Policy Document on Remote Supervision. The minister stresses that the shareholder rights he exercised on behalf of the State should not be confused with the legal powers that he exercised as Minister of Finance. He observes that the formulation of legal provisions, company articles of association and rules of procedure consistently explained his role. Strictly speaking, the minister's powers, if he had any, were not concerned with the exercise of shareholder rights. In his opinion, they were exercised to promote the public interest.

Regarding the desirability of documenting the agreements on the exchange of information with DNB, the minister refers to a clause in the Bank Act 1998 on the exchange of information on DNB's tasks and activities. Regarding the provision of information to the House of Representatives, the minister refers to the ECB's annual report, DNB's annual report and hearings on request with the president of DNB.

The minister agrees with our recommendation that preparations for decision-making should make a clear distinction between his role as shareholder and his role as guardian of the public purse. He stresses the importance of making clear agreements on risks and profit distributions that provided assurances on financial and economic stability and the efficient allocation of resources. The minister notes that talks currently being held with DNB to reach a long-term agreement regarding its capital policy would lead to a more consistent profit distribution. According to the minister, this will require a balanced, orderly and structured decision-making process that provides specific insight into the minister's various interests. He says parliament would be informed as soon as the talks led to changes in DNB's capital policy.

5.2 Court of Audit's afterword

We are grateful to the minister for his detailed response to our report. His description is a step towards clarifying his role as shareholder of DNB and the implementation of its monetary tasks. The minister's explanation shows that the relationship between DNB and the Minister of Finance may be a relationship between two parties but in reality it comprises several formal roles, tasks and powers, each having its own relationship with the others. The description would therefore be more persuasive if the minister had stated what information he needed in his role as shareholder and what information he needed in his role as guardian of the public purse. This would remove potential uncertainties about the minister's role vis-à-vis the mitigation of DNB's monetary policy risks.

We agree with the importance of an orderly process to take a decision on DNB's capital policy, with explicit insight being provided into the minister's various responsibilities, and we will follow developments with interest.

Appendix 1 Audit methodology

The question at the heart of our audit was, how did the Minister of Finance fulfil his role as shareholder of DNB when deciding to give DNB a guarantee in 2013 and allowing it to form a provision in 2016.

This primary question was worked out into three secondary questions:

- What is the Minister of Finance's policy in his role as shareholder of DNB and how does he deal with the various interests at play?
- What information is provided to the Minister of Finance to fulfil his role as shareholder of DNB?
- How does the minister assess this information in the light of conflicting interests?

To answer these questions we applied the following standards in respect of the Minister of Finance:

- the minister's relationship to DNB must be clearly defined and documented with a view to his responsibilities and the information he wishes to receive from DNB;
- in his role as shareholder, the minister must take a critical attitude to how DNB deals with risks;
- decision-making by the ministry's staff must take verifiable and explicit account of the State's various interests (separation of roles).

Our audit used information provided by the Ministry of Finance and information provided by DNB to the ministry. We indicated in advance what kind of information we would need to answer our audit questions. We also gained information by holding interviews with staff at the Ministry of Finance.

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Appendix 3 Noten

1 This following ECB programmes are relevant: Securities Market Programme (SMP), Long Term Refinancing Operations (LTRO) and Covered Bond Purchases Programmes (CBPP1 and CBPP2).

2 The eurozone is the collective name for the EU countries that have introduced the euro.

3 In full: Treaty on the Functioning of the European Union (TFEU).

4 The terms asset and sovereign debt purchase programme are also used to describe the ECB's bond purchase programme. We have used the term most frequently used by DNB and the Ministry of Finance: purchase programme.

5 The European System of Central Banks is made up of the ECB and the central banks of all EU member states, i.e. the central banks of both the euro member states and of the member states that have retained their national currencies.

6 ECB, Convergence Report, June 2016, p. 25: 'The event of a national central bank's net equity becoming less than its statutory capital or even negative would require that the respective Member State *provides the national central bank with an appropriate amount of capital* at least up to the level of the statutory capital within a reasonable period of time so as to comply with the principle of financial *independence*.' (Emphasis added by the Netherlands Court of Audit.)

7 We considered the provision of information and decision-making on the guarantee in our report *Financial Risks to the Netherlands of International Guarantees* of September 2013 (section 4.1.3).

8 Following the clearance procedure, section 2.2 was edited on some points.

9 The € 5.7 billion guarantee provided by the State is disclosed in the budget and annual report at face value. Changes in DNB's risk model did not affect its carrying value. Accounting regulations do not require the Minister of Finance to report changes in the risk exposure in his budget or annual report.

10 DNB's annual reports show that the risks were € 2.2 billion lower in 2016 than in 2015 (see also table 1 of this report).

11 The annexe to *Remote Supervision* includes a detailed description of the relationship, including what information is provided to the minister and when.

12 To safeguard DNB's independence, certain regular shareholder powers are excluded under Book 2 of the Dutch civil Code. As shareholder of DNB, the Minister of Finance cannot, for example, be involved in strategic decisions and major investments.

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