

## Ministry of Finance

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**Our reference**

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Subject Ongoing progress in the functioning of the Banking Union

Dear Ms Nouy,

Through this letter I would like to send you my warmest congratulations on your three year anniversary as Chair of the Supervisory Board of the European Central Bank (ECB). Since you took office, major steps have been taken at unprecedented speed. This is therefore an appropriate moment to take stock of the considerable achievements made and assess the functioning the Banking Union in view of further contributing to the soundness of the European banking system. I write to you in my capacity as Minister of Finance of the Netherlands.

As acknowledged by the Council of Ministers in the roadmap to complete the Banking Union, your institution is actively contributing to financial stability, reversing fragmentation, mitigating moral hazard and reducing the risk for the involvement of public financial means. The roadmap also laid down further steps that will have to be taken in terms of further reducing risks in the financial sector as well as on the remaining risk sharing elements of the banking union. While in the roadmap a number of new legislative measures have been mentioned, I do believe there is further possible room for improvement within the existing regulatory framework. This is why I very much welcome a continuous dialogue in view of enhancing consistency, predictability and transparency within the Banking Union.

In this regard, I would like to recall the importance of the financial health check of 130 banks, which was a crucial step in preparing the Single Supervisory Mechanism (SSM) to become fully operational in 2014. This Comprehensive Assessment, comprising of an Asset Quality Review (AQR) followed by two stress test scenarios, gave both markets and regulators valuable insights into the health of banks that would come under direct supervision of the ECB at the time. These results clearly showed investors banks' current capital shortfalls. As a result of this exercise a significant amount of additional provisioning was recognised in banks' financial statements. In the same vein, disclosures thereafter have also proved to be very useful, such as the 2015 Comprehensive Assessment for Greek banks. The increased transparency allowed different stakeholders involved - including also new

private investors - to make well informed decisions in view of recapitalising and restructuring the financial sector.

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The subsequent stress tests and transparency exercises as published by the European Banking Authority (EBA) have also increased transparency on the financial situation of banks. However, it should be noted that while these stress tests show markets how resilient banks are to a scenario of severe stress, they do not give a complete picture of the current health of banks. It was exactly for that reason that the stress scenarios in the earlier Comprehensive Assessment(s) were preceded by an AQR. Moreover, the most recent stress test (in 2016) only provided the public with information on a select sample of significant banks and it was somewhat unclear what benchmark the SSM applied. Although, I am confident that the SSM very thoroughly assesses the current health of all banks, through the Supervisory Review and Evaluation Process (SREP) and on-site inspections, these efforts do most of the times take place outside the public eye.

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This is one of the reasons why I have on several occasions raised the question, whether independent, public disclosed audits, such as AQRs could be performed on a more regular basis. Markets and policy makers are continuously in need of transparent and consistent data on individual banks, for example when assessing the situation of non-performing loans, provisioning and underlying collateral. More insight into banks' current health can in many ways also help banks, because it increases the markets' ability to make well informed decisions and therefore increases banks' capacity to raise capital. It would therefore be worthwhile to see whether there is room for more regular AQRs in a proportionate manner where results are clearly reflected in reporting on banks' own funds. An AQR could be performed for banks that are in need of fresh capital and in particular before the use of precautionary recapitalisation.<sup>1</sup> The added value of an AQR for banks that are dealing with a high level of non-performing loans could also be considered in order to ensure adequate provisioning and collateral valuation.

Another area related to transparency which I would like to reiterate is the exchange of information between relevant institutions and authorities. In this regard, the observations presented by the European Court of Auditors (ECA) in their special report of November 2016 deserve our attention. While I welcome the fact that the ECB generally accepted the recommendations and is willing to further work constructively, the ECA did consider that the access to documents during the audit was limited and therefore the ECA was not able to completely assess the functioning of the ECB in respect of its supervisory tasks. I therefore strongly welcome the willingness of the ECB to investigate, together with the ECA, the legal possibility of an agreement to allow the ECA to have sufficient access to information.

In the same vein, sufficient access to information - with appropriate safeguards in view of confidentiality - is also of crucial importance for the Single Resolution Board (SRB) to be well prepared for possible resolution cases. Therefore it might be worthwhile to consider whether the current set-up, including the current

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<sup>1</sup> See for example the requirement that "The aid shall not be used to offset losses that the institution has incurred or is likely to incur in the near future" as discussed in the Commission decision in case 'SA.43364'.

involvement of the SRB in the Supervisory Board, suffices and would be adequate for future circumstances. It is crucial that the SRB is in all cases able to fulfil its independent role in the process of triggering the resolution decision. In light of that it could be considered to invite the SRB as a permanent observer to the Supervisory Board.

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To ensure the credibility of the Banking Union, it is crucial to also be mindful of possible conflicts of interest. Given the importance of a clear separation between the ECB's monetary policy and supervisory functions, as the ECA has pointed out, it is key to examine the risks posed by shared services between the different functions. I therefore welcome that the Commission review on the SSM will evaluate the effectiveness of the separation between supervisory and monetary policy arms of the ECB. Should it be necessary it could be considered whether it is necessary to further clarify the relationship between the Supervisory Board and the Governing Council.

Finally, in view of improving transparency, consistency and predictability, I also believe it is worthwhile to consider not only the disclosure of banks' information, but also the requirements imposed on those banks. For example, in the context of stress test scenario's, I would like to underline the importance of a consistent use of bank samples for different exercises and a clear communication in advance on the applicable benchmarks used, as well as the consequences of the results for banks. Similarly, I would also like to raise the importance of banks' ability to disclose Pillar 2 capital requirements and guidance. Such requirements are currently not always public, although disclosure of it could facilitate market discipline and investor decisions.

Let me once again thank you for your work in contributing to the safety and soundness of the European banking system. I look forward to exchanging views with you on these ideas in more detail.

Yours sincerely,

Jeroen Dijsselbloem  
Minister of Finance of the Netherlands

CC: Ms Elke König (Chair, SRB), Mr Mario Draghi (President, ECB), Mr Valdis Dombrovskis (Vice-President) and Ms Margrethe Vestager (Commissioner)