Restoring trust

Advisory Committee on the Future of Banks in the Netherlands

Cees Maas, *Chairman*
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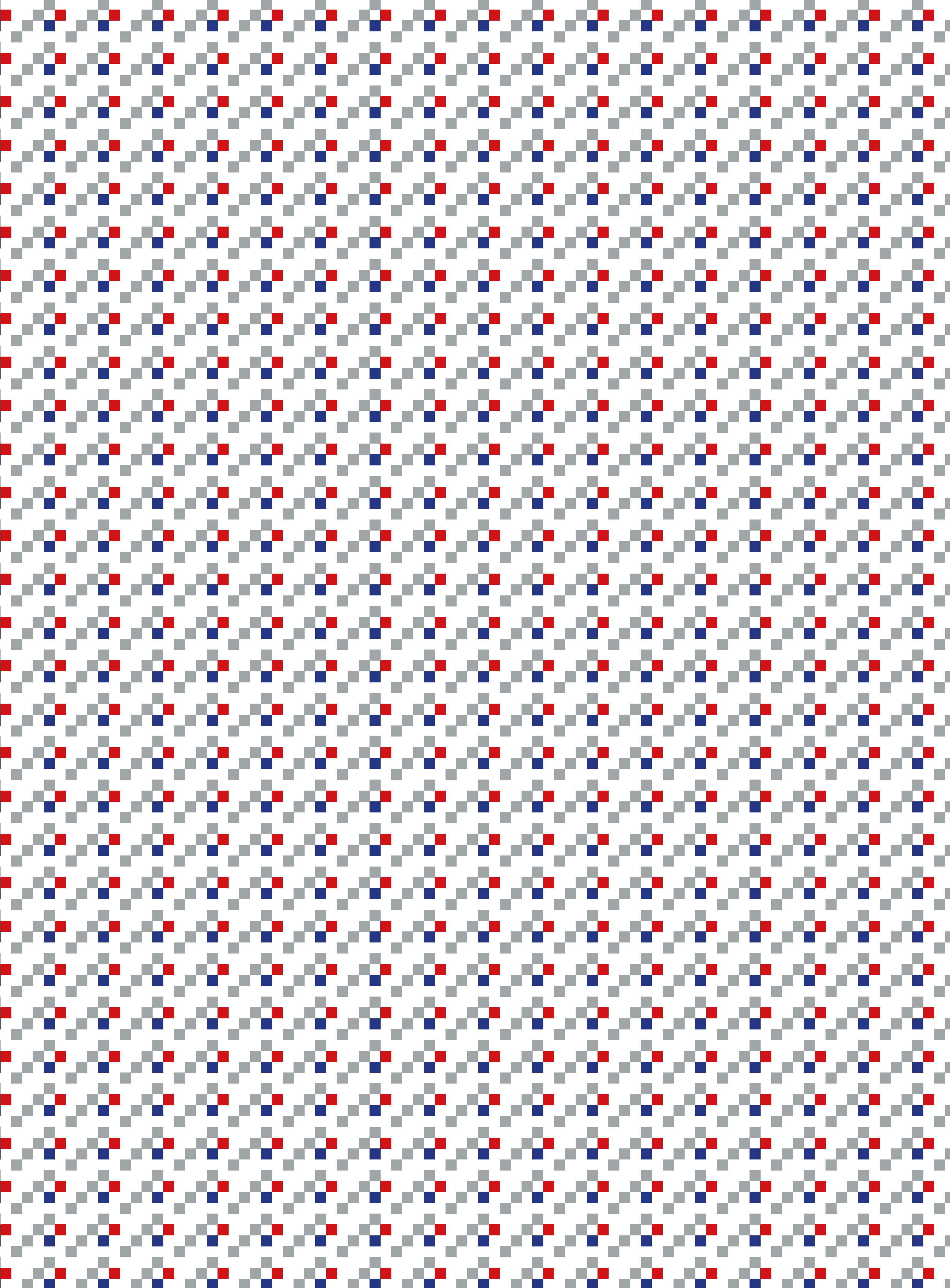

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Contents

Introduction 7

Chapter 1

Governance and Risk management 11
- Governance 12
- Risk management 17

Chapter 2

Public role of banks 21
- Remuneration policy 22
- Shareholder structure 25

Chapter 3

Regulation and Supervision 29
- Supervision 30
- European supervision structure 32
- Deposit-guarantee scheme 35

Chapter 4

Future of Banks in the Netherlands 39

Annexes

1. List of recommendations 44
2. Reports consulted 54
3. Advisory Committee on the Future of Banks in the Netherlands 56

About this publication 58

Introduction

The Advisory Committee on the Future of Banks in the Netherlands (*Adviescommissie Toekomst Banken*) was set up in November 2008 by the Board of the Netherlands Bankers' Association (*Nederlandse Vereniging van Banken*). The Committee is entirely independent and makes its advice available to the public. The Committee's main duty is to issue recommendations to improve the functioning of the Dutch banking sector, thus providing tools that will help to restore confidence in the banks. Confidence in banks has been dealt a heavy blow by the financial crisis worldwide, including in the Netherlands.

Although many different parties have played a role in the credit crunch, the Advisory Committee focuses on the banks' own responsibility in this report because the Committee believes that this approach is an important step towards responsible and sustainable banking. The central theme of the report is that banks, in balancing the interests of clients, shareholders, employees and the society in which they operate, must make the client's interests their main concern once again. Banks will then be in a better position to fulfil their public function. This will also benefit the interests of the employees and the shareholders. A situation in which profits accrue to the shareholders and bonus schemes while the losses are charged to taxpayers, clients and employees is no longer acceptable. A fundamental change of mentality and reorientation are therefore required in the banking sector. The recommendations in this report are meant to contribute to that development. The ultimate objective is that banks should serve their clients and thereby society as a whole to the best of their ability, thus restoring the confidence that has been lost in the banking system.

Restoring confidence in the banks is crucial because banks play a pivotal role in the economy. As soon as they run into difficulty, nearly all sectors of the economy are affected. This is exactly what has happened since the summer of 2007: what started as a financial crisis has developed into an economic crisis and subsequently into a crisis which effects the society as a whole. Apart from the loss of confidence in the economic role played by the banks, confidence in their public role has also been seriously damaged. In addition, doubts have arisen about bankers' ethical and moral views and conduct. These doubts are further fuelled by the high variable remunerations (bonuses) which used to be and on occasion still are awarded to bankers.

The global unrest in the financial markets has been manifest since the summer of 2007. The collapse of Lehman Brothers created distrust among banks worldwide, which in turn restricted their willingness to lend. After the fall of Lehman Brothers, it was far from clear which other banks would be affected by further asset write-downs, and to what extent. Banks distrusted each other and feared that fellow banks were no longer able to fulfil their obligations. This caused the interbank money market to dry up, which inevitably had an impact on the real economy soon afterwards. The distrust also spread to investors, who could no longer assess the actual value of banks. As a result, share prices fell. In some cases, the investors' lack of trust in banks spread to the savers and the holders of deposit accounts in those banks. A massive amount of financial support was required from Central Banks to sustain adequate liquidity, and, in some cases, governments had no other option than to provide banks with capital injections or to take over banks either partly or entirely. It also became increasingly difficult for banks to attract medium-term financing without a government guarantee. The situation has since developed to a point where the effects of the credit crunch can be felt every day throughout society, and the Netherlands is officially in a recession.

This report consists of four chapters. Chapter 1 contains recommendations which are meant to reinforce the governance structure and banks' risk management systems. There are recommendations concerning the role and position of the Supervisory Board, of the Executive Board and of the external auditor. Chapter 2 provides recommendations on banks' remuneration policies. Although there are many developments in this regard at international level as well, the Advisory Committee considers it important to set clear parameters for Dutch banks on this subject. This chapter also addresses the position of the shareholders from the perspective of the public function that banks play. Chapter 3 contains recommendations to reinforce the supervision of banks in the Netherlands. The report ties in with advice already given internationally and highlights a number of aspects as regards reinforcing supervision in the Netherlands. The report includes recommendations regarding the position of the Netherlands in the European debate about the European supervision structure and the Deposit-guarantee scheme.

Finally, Chapter 4 outlines the basis for the structure of the Dutch banking sector going forward and makes a number of recommendations in this regard.

Most of the recommendations in this report are practical advice to banks in the Netherlands. Although the recommendations are best practices that can be introduced in the short term, they are also structural recommendations. Where possible, account has been taken of the highly international nature of the Dutch banking sector, which means that in addition to remaining competitive across national borders, Dutch banks must also be able to handle the competition from foreign banks in the Netherlands.

In the opinion of the Advisory Committee, the recommendations presented in Chapters 1 and 2 are not optional. They concern situations where the "comply or explain" principle applies. Banks have to carry out the recommendations. If they fail to do so, they have to explain why

the recommendations are not being implemented. Some of the recommendations on governance and remuneration are similar to recommendations made in the Dutch Corporate Governance Code, but they have been tightened specifically for banks by the Advisory Committee. As a result, some points may differ from the usual practice in the Netherlands for businesses other than banks. This applies to certain elements of the section on remuneration, for example.

The Advisory Committee takes the view that the recommendations in Chapters 1 and 2 should be implemented as soon as possible. Where approval from the shareholders is required or contracts have to be renegotiated, the adjustments should have been made within one year at the latest.

Chapters 1 and 2 expressly do not advocate self-regulation. As stated earlier, the aim of the Advisory Committee has been to issue best-practice recommendations for the banking sector. Whether and on which points lawmakers, supervisors, auditors or others wish to introduce supplementary laws or regulations is obviously these parties' own responsibility.

Some of the Advisory Committee's recommendations are derived from recommendations by the Institute of International Finance (IIF)[1], except that they have been tailored to the Dutch context. In the summer of 2008, this global association of banks issued recommendations to restore confidence in financial institutions and markets. In addition, the recommendations were drawn up with due regard for the recent report by De Larosière *et al*.[2], in particular where they concern European supervision.

With this report, the Advisory Committee aims to make a contribution to responsible and sustainable banking in the Netherlands. It hopes that its future-oriented recommendations will be a step towards the restoration of confidence.

7 April 2009

1 Institute of International Finance, Final Report of the IIF Committee on Market Best Practices: Principles of Conduct and Best practice Recommendations, Washington, 2008.
2 De Larosière *et al*. (2009), Report by the High Level Working Group on Financial Supervision in the EU.

01

Governance and Risk management

Introduction

Fundamentally the financial crisis is the result of the systematic underestimation of financial risks in recent years, most obviously and especially by banks. Other parties, such as supervisors, monetary authorities, rating agencies, auditors, standard setters, investors, savers and others were not always successful either in assessing the risks correctly and in time. This underestimation resulted in inadequate prices for taking risks. In the recent past, banks often lost sight of complex risks, even though the proper management of those risks is one of their key competencies. A combination of low interest rates, euphoric markets and strong pressure to generate ever-increasing profits caused the picture of the whole of those risks to become unacceptably blurred. Inadequate risk policy at group level had the effect that vital risks were not or were incorrectly managed. Restoring the balance between commercial interests and responsible risk management requires structural adjustments at that same group level. A healthy risk culture must again become the point of departure in the management of every bank and of every bank executive. This may be an important step towards restoring trust. This chapter contains proposals for reinforcing banks' internal governance systems so as to guarantee broad-based, high-quality risk management. Furthermore, recommendations are made to improve risk management at product level.

Governance

Supervisory Board

Preamble

The Dutch governance model, with its division of powers and responsibilities between the Supervisory Board and the Executive Board in principle offers sufficient safeguards to ensure that all the aspects of the operations of banks receive enough attention. In this model, the Supervisory Board has the duty to supervise the strategic policies (including the risk management) of the Executive Board and to provide the Executive Board with solicited and unsolicited advice. This means that the Supervisory Board should be able to form a balanced and independent opinion. Owing to the specific complexity and risks that are characteristic of the banking business and the public role of the banking sector, the members of the Supervisory Board have to meet special requirements. The Supervisory Board must possess great expertise and experience in the financial world. In addition, the Supervisory Board must have sufficient diversity and social sensitivity. If the Supervisory Board is to function properly, it is essential that there is a culture of openness within the Supervisory Board and between the Supervisory Board and the Executive Board, and that the two boards are constantly challenging each other in order to ensure optimum performance.

Recommendations

1.1 Every bank should draw up a profile for the Supervisory Board as a whole, as well as profiles for the individual members. This profile should state that every supervisory director must have sufficient knowledge to form a balanced and independent opinion regarding the bank's basic risks. Although this condition will preferably be fulfilled at the time of appointment, it should be fulfilled in any case within three months of the supervisory director taking up office. Additional competence and experience requirements apply to members of the Audit Committee and the Risk Committee. The profile should also state explicitly that the members must have a thorough knowledge of the public functions of a bank and the interests of its stakeholders.

1.2 The Dutch Central Bank (*De Nederlandsche Bank*) should assess not only the properness of each member of a bank's Supervisory Board, but also the expertise of each Board member. This expertise assessment by the Dutch Central Bank should be legally enshrined as soon as possible.

1.3 In order to ensure a balanced distribution of the multitude of duties and to have sufficient qualified members for the various committees of the Supervisory Board (Audit Committee, Remuneration Committee and Risk Committee), a bank's Supervisory Board must consist of sufficient members. The Supervisory Board of a large bank should have at least ten members, while that of a small bank should have at least six members.

1.4 The Chairman of a bank's Supervisory Board should have extensive experience in the financial sector. Furthermore, the Chairman should have broad knowledge of the bank and of the bank's culture. In addition, he/she should be aware of the socio-political culture in the Netherlands and should be able to be present in person on a sufficient number of occasions.

1.5 The members of the Supervisory Board should receive compulsory further training every year in order to keep up to date with the developments at the bank. Such further training relates to the developments in the bank and the banking sector, to governance in general and to governance in the financial sector in particular. Failure to attend this further training should result in the Dutch Central Bank withdrawing its "certificate of no objection" for the supervisory director concerned.

1.6 Holding a Supervisory Board Membership at a bank will take up a greater amount of time than was the case to date. Therefore the remuneration should be increased accordingly.

1.7 Where Supervisory Board Members are not resident in the Netherlands, there should also be guarantees that they can devote sufficient attention and time to their Supervisory Board Membership.

1.8 In addition to the annual evaluation of its own performance, the performance of the Supervisory Board and its members should be assessed once every three years under external guidance. The involvement of the members of the Supervisory Board, and the culture of openness within the Supervisory Board and towards the Executive Board should be part of this evaluation.

Preamble

Because too much stress was placed on growth and short-term yield (the shareholders' interest), banks took greater risks in the run-up to the crisis, both for themselves and for their investing clients. Restoring the balance between commercial interests and the client's interests and responsible risk management requires structural adjustments at management and supervisory level. A healthy risk culture must again become part of banks' overall conduct of business. The Supervisory Board's responsibilities therefore need to be tightened.

Recommendations

1.9 A bank's Supervisory Board should have a Risk Committee and an Audit Committee. The Chairman of the Risk Committee should sit on the Audit Committee, while the Chairman of the Audit Committee should sit on the Risk Committee. Both chairmen should have sufficient experience in the financial sector.

1.10 The Supervisory Board or the Audit Committee should consult the internal and external auditors systematically without the involvement of the Executive Board. The Audit Committee should be the primary point of contact for the external auditor.

Executive Board

Preamble

The Executive Board is responsible for formulating and implementing the bank's policy and managing the day-to-day operations. In view of a bank's public functions, greater emphasis should be placed in this context on the social responsibilities and moral obligations of bankers. In addition, lifelong learning should be a standard element of a bank executive's agenda.

Recommendations

1.11 A bank's Executive Board and its members should base their actions on a balanced consideration of the interests of the savers, clients, shareholders, employees and the society in which the bank operates. The main focus of this consideration should be on the savers and clients.

1.12 Greater diversity in a bank's Executive Board will further a more balanced consideration of the bank's commercial interests and the risks to be taken. In particular, the Committee recommends that a bank's Supervisory Board should actively seek to increase the number of women on the bank's Executive Board.

1.13 Bank executives should sign a statement regarding ethics and morality. The text of this statement might read as follows:

"I declare that I will perform my duties as a banker with integrity and care. I will carefully consider all the interests involved in the bank, i.e. those of the clients, the shareholders, the employees and the society in which the bank operates. In this consideration, I will give paramount importance to the client's interests and inform the client to the best of my ability. I will comply with the laws, regulations and codes of conduct applicable to me as a banker. I will observe secrecy in respect of matters entrusted to me. I will not abuse my banking knowledge. I will act in an open and assessable manner and I know my responsibility towards society. I will endeavour to maintain and promote confidence in the banking sector. In this way, I will uphold the reputation of the banking profession."

1.14 Before the appointment of a bank executive, the Dutch Central Bank will issue a certificate of no objection in respect of each executive. The individual executive should sign the Banker's Statement when applying for the certificate of no objection. Current bank executives should sign the Banker's Statement as soon as possible.

1.15 The Executive Board should ensure that relevant groups of employees sign a statement comparable to the Banker's Statement. Furthermore, the content of the Banker's

Statement should be taken on board by all the bank employees and be reflected in the bank's 'business principles'.

1.16 Before taking up office, newly-appointed bank executives should pass a banking examination for executives. In special circumstances, this banking examination may be deferred – after consultation with the Dutch Central Bank – for a maximum period of one year.

1.17 The members of the Executive Board should receive compulsory further training every year in order to keep up to date with the developments at the bank.

Preamble

The management of the risk policy should be conducted explicitly and visibly at the highest level in the banking group. In practice, the Executive Board will have more members managing a commercial activity than members responsible for the risk position within the bank. Therefore the post of Chief Risk Officer (CRO), who should in any case be a member of the Executive Board, must be more firmly embedded.

Recommendations

1.18 The Chief Executive Officer (CEO) should be explicitly responsible for the risk culture and the risk appetite at the bank.

1.19 The Chief Risk Officer (CRO) should be a member of the bank's Executive Board. This position may also be combined with the position of Chief Financial Officer (CFO), on condition that the CFO/CRO does not bear responsibility for the commercial banking business. Both the CFO and the CRO should have an oversight role.

1.20 The Chief Risk Officer should be involved at all stages of the decision-making process for all important decisions that may have implications for the bank's risk profile.

External auditor

Preamble

Auditors occupy a unique position in the system of banks, clients, investors and supervisors. It is they who decide, based on their expertise, whether a company has given a true and fair picture of its equity and result in its annual report. They express an opinion on the continuity of the company. In recent years, auditors of banks have faced ever-increasing challenges due to the growing complexity of the institutions, of financial products and of valuation rules. The added value of the auditor's audit of a bank's financial and operating activities should be increased. In addition, attention must be redirected at the allocation of roles and possible forms of collaboration between the supervisors and the external auditor.

Recommendations

1.21 The external auditor should form an in-depth opinion of the actual functioning of governance within the bank. The Executive Board and the Supervisory Board should be informed of the relevant findings.

1.22 In order for both the Risk Committee of the bank's Supervisory Board and the external auditor to work effectively, a periodic exchange of information between the two is required, preferably twice a year. On that occasion, the Risk Committee will receive the auditor's risk analysis and audit plan while the external auditor will receive the Risk Committee's documents.

1.23 Relations between the external auditor, the Dutch Central Bank and the supervised bank should be intensified. Early coordination between the parties as regards the risk analysis and the audit procedures will increase the effectiveness of supervision.

Risk management

Preamble

Formulating the 'risk appetite' is an important part of a bank's risk strategy. A bank's risk appetite as a whole can be defined as the bank's willingness to accept the risk of a certain amount of loss and equity reduction, based on exceptional circumstances that may occur within a certain period. The risk appetite must be determined taking into account the bank's strategy, objectives, competitive position and nature. The Supervisory Board must be informed at regular intervals about the actual risk profile in relation to the approved risk appetite.

Recommendations

1.24 The Supervisory Board should approve, and where necessary adjust, the bank's risk appetite at least once a year. The Supervisory Board should regularly discuss the bank's actual risk profile.

1.25 The Risk Committee of the Supervisory Board should prepare the decision-making and discussions in the Supervisory Board about the bank's risk appetite and actual risk profile.

Preamble

By allocating capital and human resources, the Executive Board gives substance to the risk appetite approved by the Supervisory Board. In this way, the Executive Board decides on the risks attached to client groups, product groups and geographic diversification and on the measures to control these risks in an adequate manner. A balanced opinion can only be formed if the flow of information from the organisation to the Executive Board and, where necessary, the Supervisory Board is optimal in terms of quality and quantity.

Recommendations

1.26 The bank's Supervisory Board, based on the preparatory work by the Risk Committee, should supervise the elaboration of the overall risk policy by the Executive Board, in particular with regard to capital allocation and liquidity requirement in accordance with the risk appetite of the institution and with regard to the observance of the limits derived from that risk appetite.

1.27 The bank's Executive Board should organise the risk management system in such a way that it has timely and ongoing knowledge of the risks run in respect of the allocated capital. Decisions that have a material impact on capital allocation and liquidity requirement in the bank, and therefore on the total risk profile, should be taken by the Executive Board and approved by the Supervisory Board. This concerns the allocation of capital to activities and geographical areas as well as to product groups.

1.28 The Supervisory Board should assess periodically whether the products carried or the client groups served by the bank are compatible with the bank's overall risk policy and nature. The Executive Board should provide the Supervisory Board with the information in such a way as to enable the latter to form a well-founded opinion on this information.

Preamble

The Product Approval Process is the procedure by which the bank decides whether it will produce or distribute a particular financial product at its own expense and risk and/or for the benefit of its clients. The Product Approval Process usually involves various departments within the bank. During the approval process, careful consideration is given to the risks at issue, including those concerning the required duty of care and the applicable business principles. It is the responsibility of the Executive Board to have adequate processes that guarantee compliance with the internal and external regulations. By following the entire Product Approval Process and respecting the contributions to this process from the non-commercial departments, the bank ensures that products which it carries and/or markets or distributes at its own expense and risk comply with the requirements of prudent risk management and with the duty of care towards the client, and are in keeping with the bank's business principles.

Recommendation

1.29 It should not be possible to market or distribute new products without the express consent of the risk management office at the bank. Risk management is responsible for the adequate operation of the Product Approval Process that every bank should have in place. Clear instructions should be issued to product and commercial managers stating that they are responsible for ensuring that the results of the Product Approval Process are respected on a permanent basis. The internal auditor should check that this is the case. The Supervisory Board's Risk Committee is kept informed at regular intervals through the internal auditor's reports.

02

Public role of banks

Introduction

Most banks in the Netherlands have an important public service function, which is a public role that makes them different from other businesses. The awareness of this public service function has increasingly faded in recent years. In practice, this meant that many banks were giving increasing priority to the interests of the shareholders, and, in doing so, they attached de facto less importance to their clients and society as a whole. In this sense, there was a disproportionate increase in the power of shareholders in the stakeholder model (which consists of the clients, the employees, the shareholders and society as a whole) during the last ten years, whereby the shareholders (who usually have a short-term focus) impeded a sustainable, long-term focus in business strategy of banks.
This resulted in increasing attention being paid to short-term profit development, which therefore weakened longer-term risk management. Consequently, the interests of the client, and thereby of society as a whole, slipped too much into the background. The usually profit-related variable income component, in particular among those at the top of the banking sector, has rocketed in recent years.
In many cases, therefore, restricting the variable income component of top bankers is desirable.
The culture of variable remuneration (“bonuses”) throughout the industry must be reassessed.
This chapter contains specific recommendations regarding how to achieve a healthier remuneration structure, in which non-financial and longer-term targets play a greater role than they have done to date.

Remuneration policy

Preamble

Both the absolute level and the structure of executives' pay in the banking sector must be consistent with responsible internal risk management and conform to generally accepted views in society regarding what is a justified level of remuneration. By and large this has not been the case in recent years. A policy aimed at restraint and restructuring is therefore desirable. Obviously this cannot be done without considering the nature of the (international) activities of an individual bank and the need to continue recruiting top talent for the top positions in the Dutch banking sector. In the opinion of the Advisory Committee, the labour market for bank executives currently provides the opportunity to restrain and restructure the total remuneration of top executives in the banking sector and that of the relevant lower levels.

Recommendations

2.1 The total income of bank executives should be slightly below the median[3] of comparable positions in and outside the financial sector. Furthermore, the total income should be in reasonable proportion to the remuneration scale system at the bank. The Supervisory Board[4] assesses whether the top executives' pay is in reasonable proportion to income at lower levels, and reports accordingly to the General Meeting of Shareholders.[5]

2.2 A bank's Supervisory Board should first approve the total remuneration of the individuals in the first layer below the Executive Board, before the Executive Board actually pays them.

2.3 A bank's Supervisory Board should have an annual discussion about the highest variable incomes throughout the company, before these incomes are awarded by the Executive Board. The Supervisory Board should also discuss the retention packages and so-called 'golden hellos' awarded to this group of employees. The Supervisory Board should ensure that these income components are not excessive.

3 "Slightly below the median" is a reference to the notion that bank executives should **follow** rather than **set** the trend.
4 Where this text refers to the Supervisory Board, it is assumed that the decisions of the Supervisory Board are prepared by the Remuneration Committee.
5 Or a comparable body for legal forms other than a company.

2.4 The structure of the total income of a bank's top executives should be reflected in the structure of the rest of the income scale system.

2.5 If the award of the variable income has manifestly undesirable consequences (for instance on account of a merger, acquisition, or otherwise), a bank's Supervisory Board, in awarding the variable income, should have the discretionary power to deviate from the variable income that would have been awarded on the basis of the targets originally set. Likewise, if the ultimate payment of the variable income has manifestly undesirable consequences, the Supervisory Board should have the discretionary power to award that variable income in a different manner. In assessing these undesirable consequences, the Supervisory Board will be guided by the interests of all the stakeholders. The Board will be accountable to the General Meeting of Shareholders for its choices.

2.6 The exit provisions of the Dutch Corporate Governance Code should also be applied by banks. So-called 'golden parachutes' should not be awarded. This means that the level of a severance payment for an executive should not exceed the fixed component of the annual salary.

Preamble

Recently, various banks have placed (too) much emphasis on the interests of shareholders, although this group is only one of a bank's (four) stakeholders. The interests of the clients, the shareholders (and other capital providers), the employees and society as a whole will have to be brought back into balance with each other.

Recommendation

2.7 A significant portion of the criteria on which the variable income for bank executives is based should consist of non-financial targets covering issues such as client satisfaction, risk management, investor relations, operating targets, human resources, integrity, compliance, sustainability, etc. Although such non-financial targets are more difficult to quantify, it is important to make them as objective as possible.

Preamble

Remuneration policy has become increasingly complex in recent years. Following on from (large) foreign banks, the Dutch banking sector has made the variable income component an increasingly important element of total remuneration with the variable income component often having a short-term and a long-term aspect. Unfortunately, the chosen systems are usually structured in such a way that a successful performance in relation to specific predetermined targets leads to high variable income whereas a poor performance rarely leads to zero variable income. Remuneration policy with regard to taking risks therefore has an asymmetric effect in practice. In addition, high profits are often generated by employees that take great risks for the bank while using a large amount of capital in the process. This may mean that there is, in a sense, 'an incentive to behave badly'. In order to create a better balance between the taking of risks and the awarding of variable income, limits must be imposed on the extent of the variable component and asymmetry must be prevented.

Recommendations

2.8 Financial targets that form the basis for the variable income of bank executives should be adjusted to take account of risks and capital costs.

2.9 The variable income of a bank's executives should be awarded annually based on the achievement of pre-set targets. Where the short-term variable income is concerned, the targets relate to one year. As regards the long-term variable income, the targets should cover several years. Also, the long-term component could be determined when the final award is made by taking account of the performance delivered in comparison to similar institutions.

2.10 If and insofar as the variable income of a bank's executives consists of cash, no more than one third of the amount awarded should be paid out in the award year. Two thirds or more should be reserved and paid out after a period of at least three – preferably four – years, with due observance of the provisions in recommendation 2.5. The variable income component may also consist of shares, but not of other components such as stock options. If the award is made in shares, these should be distributed after a period of at least three – preferably four – years, with due observance of the provisions in recommendation 2.5. The value of the shares ultimately to be distributed should be maximised.

2.11 In all circumstances, a prudent policy should be conducted in respect of the variable remuneration of bank executives. On an annual basis, the total variable income should equal no more than between 0% and 100% of the fixed income component. If the bank does not generate any profits, no variable income should be awarded to the Executive Board or to the next layer of management immediately below the Executive Board.

2.12 The maximum of 100% only applies to larger banks with extensive international operations, and to smaller banks that pay a relatively low fixed income component. Where the other banks are concerned, a (considerably) lower maximum percentage for the variable component will be sufficient, depending on the nature of the bank's activities.

2.13 A bank's Supervisory Board should aim to amend existing contracts as soon as possible to bring them into line with the recommendations made in this section, obviously in consultation with those involved.

Shareholder structure

Preamble

Under corporate law, shareholders are not obliged to take account of the interests of stakeholders other than the shareholders. Of course this also applies to bank shareholders. They are not required to take account of the other interests that play a part in a bank. These other interests are the interests of the savers, of those depending on commercial landing and of the employees, as well as the interests of society in having efficient payment services, and the importance of a healthy banking industry in general. This one-sided approach by shareholders has led to undesirable developments in the recent past. The short-term focus of some groups of shareholders has only reinforced this outlook. It is therefore desirable that measures will be taken to facilitate the reorientation of bank shareholders to bring them more into line with all the interests that play a part in a bank.

Recommendations

2.14 Every financial institution should make a choice with regard to the most desirable shareholder structure. This structure should ensure that there is a proper balance between the interests of the shareholders and those of the other stakeholders (the clients, the employees and society as a whole). The clients' interests should be the focal point of that balance.

2.15 The Committee recommends that listed banks seek a stable group of shareholders who are willing to commit themselves to the company for a longer period. This will enable these banks to concentrate on generating added value in the longer term.

2.16 Stable bank shareholders should receive extra rewards, such as a loyalty dividend distribution or increased voting rights, for example. The horizon for such stable shareholders should preferably be four years or longer.

2.17 In the interests of a meaningful dialogue between a bank and its shareholders, there should be a register of shareholders, as is the case in most of the countries of the European Union.

2.18 The issue of depositary receipts for shares in a bank may be a useful instrument to prevent a limited number of shareholders from exerting a disproportionately large influence on the General Meeting of Shareholders. To avoid a situation in which the issue of depositary receipts systematically restricts shareholders' influence, the

holders of depositary receipts present or represented at the General Meeting of Shareholders should be able to exercise their voting rights at all times.

Preamble

Since 2008, the Dutch government has had an interest in various Dutch financial institutions (banks and insurance companies) through shareholdings or otherwise. The government's decisive action at times of great need in the Dutch banking sector is highly commendable. The same applies to its willingness to retain its interest as long as the situation in the financial markets so requires. Based on the assumption that the financial markets will recover in due course and the need for a level playing field among the Dutch banks, these government participations are therefore temporary. There will be a moment when the government will dispose of its participations. That will be a major operation, involving large, not always coinciding interests. Conflicts of interest may occur between the taxpayer, the banks in which the government is a shareholder, the other shareholders, the competing financial institutions, the savers and the supervisors.

Recommendation

2.19 The government, the supervisors and the financial institutions in which the government recently acquired participating interests, whether as a shareholder or otherwise, should enter into consultation as soon as possible about the future shareholder structure of the institution concerned, the manner in which shares or other interests will be disposed of in the longer term and all other aspects relevant to such a disposal process.

03

Regulation and Supervision

Introduction

Keeping savings safe, providing business and home loans and ensuring that efficient payment services are in place are the key components of the banks' role in society. If these activities are conducted effectively and efficiently, they make a major contribution to prosperity. If, however, these activities are seriously disrupted, the consequences will generally be extremely serious as well because of the extensive interwoven relationships between the banks. Therefore, it is the role of banks' internal supervision systems and of external supervisors to ensure that such serious disruptions are prevented.

As a result of the globalisation of the capital markets and the associated fierce competition, banks spent the years leading up to the current financial crisis looking for new ways to maintain and further enhance their profitability. However, the capital at the banks' disposal did not increase in line with their rapidly growing balance sheets. As a result of the fast-growing international and highly liquid capital markets, liquidity risk management was neglected. The consequences of that neglect are now all too obvious.

Because of the global nature of the financial crisis, numerous initiatives are currently being taken by governments, supervisory authorities and international banks themselves in an attempt to improve the supervision systems. The proposals relating to banks' internal risk and liquidity management, the debate about the Deposit-guarantee scheme and the structure of European supervision are especially important. In this regard, the Advisory Committee considers the so-called 'Twin Peaks' model to be an effective starting point at the national level for organising the various aspects of supervision. In this model, the Dutch Central Bank is responsible for macro-prudential and micro-prudential supervision and the Netherlands Authority for the Financial Markets (the AFM) supervises the markets and conduct of business. This chapter places international developments in a Dutch context and makes recommendations for supervision and regulation that are intended to help restore confidence in the widest sense. The Advisory Committee is in favour of a model of supervision based on principles rather than extensive rules and on an open relationship between supervisors and banks.

Supervision

Preamble

Following on from the rules and regulations and the resulting external supervision, a bank's internal management is marked by a focus on safeguarding the solvency and liquidity of the institution. In the allocation of capital (internal) and in the capital requirements (external) every effort is made to create sufficient buffers to absorb any negative impact on solvency caused by bad debt and market risks in particular. The liquidity risk is mainly managed by active balance sheet management and regular stress testing.

It is now clear that although these buffers in many cases far exceeded the external requirements, they are still inadequate in the current crisis. For accounting reasons, it is not possible to build up provisions when times are good to cover possible bad debt risks in the future. Tax considerations also make it difficult to build up the reserves that would be required. In the case of market risks, the impact of so-called 'tail risks" has been underestimated. The external supervisor does have the discretionary power to impose additional capital requirements in such cases, but to date there has been a reluctance to use this power for fear of disrupting the level playing field at the national and international level. In addition, the use of such discretionary powers demands a high level of professional knowledge and understanding on the part of the supervisors. The professionalism of the supervisors needs to be improved in this regard. This can be achieved in part through more people from supervisory authorities going to work for banks and vice versa, as well as through temporary secondments from supervisory authorities to banks and from banks to supervisory authorities.

Recommendations

3.1 The entire range of supervisory measures relating to credit risk, market risk and liquidity risk needs to be reviewed. The recommendations in the Turner report[6] can serve as the basis for the review.

3.2 Banks should create anti-cyclical buffers. Additional provisions should be accumulated during the boom years to cover possible future bad debt during an economic downturn. These additional provisions – and any withdrawals from

6 Financial Services Authority: *"The Turner Review: A Regulatory Response to the Global Banking Crisis."*

these provisions – would be published. Following on from the Banco De España and the recommendations of De Larosière et al, this prudent risk policy should be imposed by the supervisory authority – in this case the Dutch Central Bank. This policy of creating provisions must be accepted by the tax authorities.

3.3 The models used by banks to determine market risks need to take more account of events that are extremely unlikely but that would have a major impact if they do happen. This approach will mean that greater capital buffers are required. If the bank is unable to increase the level of capital, certain high-risk activities should be terminated. Supervisors should use their powers under Pillar 2 to impose additional – and where necessary prohibitive – capital requirements on the banks in question.

3.4 In addition to the capital requirements set by Basel II, the option of imposing a universal maximum leverage ratio on (certain types of) banks should be considered.

3.5 To the extent that banks push against the boundaries of the rules of Pillar 1, supervisors should use the powers available to them under Pillar 2 to prevent the banks from doing so by imposing additional capital requirements.

3.6 The professionalism of the supervisors must be at a high level across the board. This level of professionalism can be facilitated by more people moving from jobs with supervisory authorities to jobs with banks and vice versa, by temporary secondments in both directions and by a remuneration policy at supervisory authorities that reflects market rates.

Preamble

The objective of both internal and external risk management is to ensure that a bank can withstand any major shocks or other disasters. However, the credit crunch has shown that banks cannot withstand large-scale disasters, such as the collapse of systemic banks. Additional policy instruments are required to stave off such impending disasters in the future. Alongside the options of extra liquidity (from the Dutch Central Bank, the European Central Bank or government-guaranteed liquidity) and capital injections by the government, the Advisory Committee's main proposal is to expand the options available for rapid and effective intervention in a bank's problem areas. Such intervention assumes an expansion of the powers vested in the Dutch Central Bank and in government, especially in crisis situations.

Recommendations

3.7 A bank's balance sheet must always be structured in such a way as to enable government ring-fencing intervention where there is an impending crisis situation.

3.8 In an impending crisis situation bank supervisors must have extensive powers at their disposal. The options available should include the possibility of suspending the powers of the bank's bodies (Executive Board, Supervisory Board, General Meeting of Shareholders) whilst the toxic part of the bank is removed and placed elsewhere (in a 'bad bank').

European supervisory structure

Preamble

Within the framework of increasing European unity, there have been numerous European directives enacted in recent decades to harmonise the supervision of financial services. The aim of this harmonisation was to ensure that financial institutions in all EU Member States operated in accordance with the same supervisory rules. These directives, once implemented in national legislation and regulations, have contributed in no small part to the international growth of European financial institutions.

At institutional level, the European authorities have also taken steps to ensure better coordination of supervisory activities across the EU. For example, so-called 'Level 3 committees' have been established for banks, insurers and the securities market: the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR).

Although the European directives aim to create a clear framework for the implementation of micro-prudential supervision, in practice there are major discrepancies between EU Member States in the way in which the directives are interpreted. This can seriously disrupt the level playing field and competitive relationships. In cases where the national supervisors give way to the pressure to compensate for these disruptions by adjusting their own interpretation, this often results in a reduction in standards of supervision to the level of the most lax supervisory authority. This is also caused by the fact that part of the role of some supervisors is actually to promote their own financial centre.

Recommendations

3.9 An entity should be established with the CEBS that can ensure that the agreed supervision rules are applied as far as possible in a uniform manner. In this process, uniformity must not be allowed to result in the implementation of the most lax interpretation of the regulations. Competition between supervisors ('regulatory competition') is undesirable and should be countered at all costs.

3.10 The responsibility of a national supervisory authority for the promotion of its own financial centre creates a conflict of interest with the supervisory authority's core task and should therefore not be part of the authority's mandate.

Preamble

The current financial crisis has demonstrated the urgent need for a European supervisory model, especially for financial institutions that operate in more than one country. The existing supervisory model is too focused on individual countries to handle major international crises. The main aspects of the required European supervisory model are described below.

The first step is to set up a European Systemic Risk Council (ESRC), as proposed by De Larosière et al. This will meet the need for macro-prudential supervision at the European level as soon as possible.

The second element involves the establishment of a European System of Financial Supervision (ESFS) to handle micro-prudential supervision of financial institutions (banks, insurers and securities service providers) with substantial international operations. In addition, this supervisory authority must be given the power to set rules that apply to other financial institutions of systemic importance and to supervise compliance with these rules.

Obviously, the ESRC and the ESFS will need to work very closely together. The basic requirements in that regard are an effective exchange of information and clear procedures. The decision about when further integration of the two bodies is advisable should be taken based on the experience acquired.

Thirdly, it is important to remember that there is substantial interconnection between the new ESRC's task of curbing the systemic risks arising from the conduct of market parties and the ECB's task of achieving monetary and financial stability in a more general sense. It is therefore advisable, as far as is possible within the bounds of the treaty, to increase the ECB's involvement in the ESCR and therefore in the management of systemic risks.

In such a scenario the ECB provides the chairman of the ESRC and the ESRC's operational activities will be carried out by the ECB. These two provisions would create important synergy in terms of policy and information.

Recommendations

3.11 A European System of Financial Supervision (ESFS) should be established, similar to the European System of Central Banks. The primary role of the ESFS would be to provide micro-prudential supervision of those financial institutions that have substantial international activities.

3.12 The ECB's involvement in the ESRC must be firmly embedded. The ECB should provide the chairman of the ESRC and carry out the Council's operational activities.

Preamble

The establishment of a European System of Financial Supervision (ESFS) will necessitate a change in the European treaty. This will take time. In view of the serious nature of the financial crisis and the urgent need to strengthen European supervision, it is worth considering giving the three Level 3 Committees increased powers of supervision over the largest financial institutions that operate

internationally. These powers can be delegated to a national supervisor or to a council of supervisors. The Level 3 Committee will act as binding mediator in the case of conflicts.

In the run-up to the establishment of the ESFC, collaboration between the Level 3 Committees and the ECB/ESRC will need to be intensified in order to ensure that macro-prudential and micro-prudential supervisors can effectively exchange information.

Recommendations

3.13 Prior to the establishment of the ESFS, the powers of the current Level 3 Committees will need to be enhanced. The Committees will have to supervise the largest international financial institutions.

3.14 These powers can be delegated to a national supervisor or to a council of supervisors. The Level 3 Committee will act as binding mediator in the case of conflicts.

3.15 Collaboration between the ECB/ESRC and the Level 3 Committees will need to be intensified in order to facilitate optimum exchange of information between micro-prudential and macro-prudential supervisors.

Deposit-guarantee scheme

Preamble

It is both socially and economically advisable for private individuals and small businesses to be able to bank savings up to a particular maximum without fearing that they may lose their money. Savers generally entrust their savings to the bank for the short term, while banks tend to provide longer-term loans. The fact that banks convert savings into mortgage loans and corporate financing is equally important from both a social and an economic point of view. A Deposit-guarantee scheme provides protection to small and medium-sized savers. However, a Deposit-guarantee scheme also makes it possible to convert savings into longer-term mortgage loans and commercial loans.
The recent increase in the Deposit-guarantee limit, which has also been implemented in other European countries, made it clear that the Dutch Deposit-guarantee scheme needs to be seen in both the Dutch and the wider European context. It is expected that the statutory guaranteed amount will be increased to 100,000 across Europe. Assuming that this measure is primarily intended to curb the current unrest in the financial markets, it is worth considering reducing the guarantee amount – quite possibly in stages – in the longer term. The savings capacity of the majority of those involved should be used as the basis for determining the level of the guaranteed amount. A guarantee that also includes some level of risk on the part of the saver is not advisable. Individual savers cannot be expected to estimate and assess the risks of any particular bank. Furthermore, any loss of confidence in the bank combined with a level of own risk will still lead to a run on the bank.

Recommendations

3.16 In the event that there is room in due course in the run-up to European harmonisation of Deposit-guarantee schemes in 2010 for a reduction in the guarantee amount of € 100,000, any reduction must be based on the average saver. A guarantee of € 40,000 to € 50,000 would appear to be sufficient. A guarantee that also includes some level of risk on the part of the saver is not advisable.

Preamble

There are various ways to finance the burdens involved in any eventual payout under a Deposit-guarantee scheme. These include the apportionment system, the formation of funds and insurance. The Netherlands is one of the few countries in Europe that has an apportionment system.
A Deposit-guarantee scheme is in principle intended for individual bank collapses rather than for

managing a systemic crisis such as the current situation. In the event of the failure of a Dutch bank with a large amount of guaranteed savings, an apportionment system leads to a highly undesirable and virtually inevitable domino effect for the rest of the Dutch banks. The apportionment system in the Netherlands will therefore need to be reconsidered. However, any fund that may be established is also highly unlikely to be of sufficient size to cope with the failure of a major Dutch bank. The likelihood of such a situation occurring and the Deposit-guarantee scheme being invoked is, however, extremely remote, but the sums involved are very high. In such cases, an adequate method of financing is not provided by either the apportionment method or a fund. Insuring against this kind of event in the private insurance market also seems to be impossible. Effective security under all circumstances can only be provided by insuring the guaranteed savings with the government.

Recommendation

3.17 The existing apportionment method in the Dutch Deposit-guarantee scheme should be replaced by an insurance system involving an insurance premium to be paid to the government by the banks participating in the Deposit-guarantee scheme. In the event of the Deposit-guarantee scheme being invoked, the government would pay the guaranteed sums to the savers.

Preamble

The Dutch Central Bank administers the current Deposit-guarantee scheme. This should continue for the new insurance-based system. In this regard, it is the responsibility of the Dutch Central Bank to prevent the Deposit-guarantee scheme being invoked so that the insurance premiums remain as low as possible.

Recommendations

3.18 The administrator of the Deposit-guarantee scheme, the Dutch Central Bank, can set conditions to be adhered to by current and new participants in the scheme.

3.19 Admission to the Deposit-guarantee scheme should be assessed separately by the Ministry of Finance when a banking licence is awarded. The Dutch Central Bank, under mandate from the insurer, can impose additional conditions on participants in the Deposit-guarantee scheme.

3.20 Banks in which the government participates and/or for which it provides a guarantee will be participants in the Deposit-guarantee scheme.

3.21 The insurance premium in the new Deposit-guarantee scheme will have to be determined at a later date, partly depending on developments at the European level.

04

Future of Banks in the Netherlands

Introduction

The key public roles played by banks in society are to provide efficient payment services, to offer the possibility of keeping current-account balances and savings safe and to provide business and private loans. Many banks in the Netherlands (the so-called 'universal banks') already offer these core services. Other banks focus on some of these core services.

Since the Postbank (an amalgamation of Post Cheque and Girodienst (payments) and Rijkspostspaar-bank (savings)) – merged first with NMB (1989) and later with Nationale-Nederlanden to form the ING Group (1991), the provision of one or more of these core services has no longer been considered a task for the government.

Of course, it does remain a government task, in partnership with banking supervisors, to guarantee the continuity and quality of these essential core functions. In the opinion of the Advisory Committee, a system of universal banks in the Netherlands that are not owned by the government, combined with proper internal and external supervision, provides the best guarantees of an effective and efficient banking sector that maintains the public service function. The Dutch system of payment services that has developed in recent decades is considered, after all, to be one of the best and most cost efficient in the world. Furthermore, in the Netherlands, competition between banks with different backgrounds (listed on the stock exchange, small group of shareholders, cooperative, socially-oriented) has resulted in a wide range of savings options, mortgage loans and providing credits at rates and subject to conditions that – even in international terms – are generally acceptable.

Preamble

The recommendations in this report and the measures being taken nationally and internationally to implement better regulations and improved supervision are above all intended to systematically safeguard the continued provision of core banking services by private parties. In the Advisory Committee's opinion, there is no reason to assume in advance that this objective cannot be achieved. Therefore, the question of whether one or more of these core activities should (once again) be provided by the government requires only a marginal assessment. If a bank that is directly linked to the government offered savings products to the public in addition to the current universal banks, this might easily disrupt the level playing field as regards attracting savings and other funding and thereby also have a negative impact on fair competition in the provision of credit. Furthermore, experience and knowledge of political processes suggest that constantly changing political policy priorities over time would significantly influence the course of business at such a government bank, therefore resulting at least in inefficiencies and a distorted competitive situation.

Recommendation

4.1 It is neither necessary nor desirable for the government to set up or wholly or partly own banks in order to guarantee the public service functions of banks in the Netherlands, namely payments, savings and the provision of credit.

Preamble

Generally, banks do not limit their activities to offering core services for society. Their customers require wide-ranging additional services, such as currency trading, capital market transactions and securities services (the so-called 'business banking'). This means that there are also market risks, in addition to credits, interest rates and liquidity risks that are inextricably linked to these core services. In order to ensure good provision of services, it is virtually inevitable that the banks will adopt market positions. In itself this is not a problem, providing that it does not go beyond a scale where any major losses can not be absorbed by sufficient capital buffers in order to prevent the continued provision of the core services being threatened. This necessary precondition therefore justifies the universal banks' continued participation in the Dutch Deposit-guarantee scheme.

Recommendation

4.2 The provision of capital market products, as long as they are of a suitable scale, should be part of the activities of the universal Dutch banks that are eligible to participate in the Dutch Deposit-guarantee scheme.

Preamble

The situation is different, however, if the adoption of (substantial) positions by a bank becomes an aim in itself and affects significantly the bank's capacity to make a profit. Nevertheless, in itself, this is also not a problem, but the difficulties occur when the 'business bank' activities start to take precedence over the public service functions of a 'universal bank'. If the bank's activities still involved attracting savings and offering payment services to the public, the collapse of such a business bank could easily result in a systemic risk.

Recommendation

4.3 Banks that are overwhelmingly 'business banks' with a corresponding risk profile are not eligible to participate in the Dutch Deposit-guarantee scheme. This means that limitations should be set as regards their options for attracting funds from the general public.

Preamble

Not only the possible failure of a bank that is not eligible to participate in the Deposit-guarantee scheme but also the possible failure of other financial institutions, such as hedge funds, may still be accompanied by domino effects that threaten the stability of the financial system. This is an issue that needs to be addressed by the national and European supervisory authorities who are charged with monitoring systemic risk.

Recommendation

4.4 The banks that participate in the Deposit-guarantee scheme should strictly limit the extent to which they take any counterparty risk (including any potential risk) as regards financial institutions that are not part of the Deposit-guarantee scheme.

Annexes

Annex 1

List of recommendations

Governance and risk management

1.1 Every bank should draw up a profile for the Supervisory Board as a whole, as well as profiles for the individual members. This profile should state that every supervisory director must have sufficient knowledge to form a balanced and independent opinion regarding the bank's basic risks. Although this condition will preferably be fulfilled at the time of appointment, it should be fulfilled in any case within three months of the supervisory director taking up office. Additional competence and experience requirements apply to members of the Audit Committee and the Risk Committee. The profile should also state explicitly that the members must have a thorough knowledge of the public functions of a bank and the interests of its stakeholders.

1.2 The Dutch Central Bank (*De Nederlandsche Bank*) should assess not only the properness of each member of a bank's Supervisory Board, but also the expertise of each Board member. This expertise assessment by the Dutch Central Bank should be legally enshrined as soon as possible.

1.3 In order to ensure a balanced distribution of the multitude of duties and to have sufficient qualified members for the various committees of the Supervisory Board (Audit Committee, Remuneration Committee and Risk Committee), a bank's Supervisory Board must consist of sufficient members. The Supervisory Board of a large bank should have at least ten members, while that of a small bank should have at least six members.

1.4 The Chairman of a bank's Supervisory Board should have extensive experience in the financial sector. Furthermore, the Chairman should have broad knowledge of the bank and of the bank's culture. In addition, he/she should be aware of the socio-political culture in the Netherlands and should be able to be present in person on a sufficient number of occasions.

1.5 The members of the Supervisory Board should receive compulsory further training every year in order to keep up to date with the developments in the bank. Such further training relates to the developments in the bank and the banking sector, to governance in general and to governance in the financial sector in particular.

Failure to attend this further training should result in the Dutch Central Bank withdrawing its "certificate of no objection" for the supervisory director concerned.

1.6 Holding a Supervisory Board Membership at a bank will take up a greater amount of time than was the case to date. Therefore the remuneration should be increased accordingly.

1.7 Where Supervisory Board Members are not resident in the Netherlands, there should also be guarantees that they can devote sufficient attention and time to their Supervisory Board Membership.

1.8 In addition to the annual evaluation of its own performance, the performance of the Supervisory Board and its members should be assessed once every three years under external guidance. The involvement of the members of the Supervisory Board, and the culture of openness within the Supervisory Board and towards the Executive Board should be part of this evaluation.

1.9 A bank's Supervisory Board should have a Risk Committee and an Audit Committee. The Chairman of the Risk Committee should sit on the Audit Committee, while the Chairman of the Audit Committee should sit on the Risk Committee. Both chairmen should have sufficient experience in the financial sector.

1.10 The Supervisory Board or the Audit Committee should consult the internal and external auditors systematically without the involvement of the Executive Board. The Audit Committee should be the primary point of contact for the external auditor.

1.11 A bank's Executive Board and its members should base their actions on a balanced consideration of the interests of the savers, clients, shareholders, employees and the society in which the bank operates. The main focus of this consideration should be on the savers and clients.

1.12 Greater diversity in a bank's Executive Board will further a more balanced consideration of the bank's commercial interests and the risks to be taken. In particular, the Committee recommends that a bank's Supervisory Board should actively seek to increase the number of women on the bank's Executive Board.

1.13 Bank executives should sign a statement regarding ethics and morality. The text of this statement might be as follows:

"I declare that I will perform my duties as a banker with integrity and care. I will carefully consider all the interests involved in the bank, i.e. those of the clients, the shareholders, the employees and the society in which the bank operates. In this consideration, I will give paramount importance to the client's interests and inform the client to the best of my ability. I will comply with the laws, regulations and codes of conduct applicable to me as a banker. I will observe secrecy in respect of matters entrusted to me. I will not abuse my banking knowledge. I will act in an open and assessable manner and I know my responsibility towards society. I will endeavour to maintain and promote confidence in the banking sector. In this way, I will uphold the reputation of the banking profession."

1.14 Before the appointment of a bank executive, the Dutch Central Bank will issue a certificate of no objection in respect of each executive. The individual executive

should sign the Banker's Statement when applying for the certificate of no objection. Current bank executives should sign the Banker's Statement as soon as possible.

1.15 The Executive Board should ensure that relevant groups of employees sign a statement comparable to the Banker's Statement. Furthermore, the content of the Banker's Statement should be taken on board by all the bank employees and be reflected in the bank's 'business principles'.

1.16 Before taking up office, newly-appointed bank executives should pass a banking examination for executives. In special circumstances, this banking examination may be deferred – after consultation with the Dutch Central Bank – for a maximum period of one year.

1.17 The members of the Executive Board should receive compulsory further training every year in order to keep up to date with the developments at the bank.

1.18 The Chief Executive Officer (CEO) should be explicitly responsible for the risk culture and the risk appetite at the bank.

1.19 The Chief Risk Officer (CRO) should be a member of the bank's Executive Board. This position may also be combined with the position of Chief Financial Officer (CFO), on condition that the CFO/CRO does not bear responsibility for the commercial banking business. Both the CFO and the CRO should have an oversight role.

1.20 The Chief Risk Officer should be involved at all stages of the decision-making process for all important decisions that may have implications for the bank's risk profile.

1.21 The external auditor should form an in-depth opinion of the actual functioning of governance within the bank. The Executive Board and the Supervisory Board should be informed of the relevant findings.

1.22 In order for both the Risk Committee of the bank's Supervisory Board and the external auditor to work effectively, a periodic exchange of information between the two is required, preferably twice a year. On that occasion, the Risk Committee will receive the auditor's risk analysis and audit plan while the external auditor will receive the Risk Committee's documents.

1.23 Relations between the external auditor, the Dutch Central Bank and the supervised bank should be intensified. Early coordination between the parties as regards the risk analysis and the audit procedures will increase the effectiveness of supervision.

1.24 The Supervisory Board should approve, and where necessary adjust, the bank's risk appetite at least once a year. The Supervisory Board should regularly discuss the bank's actual risk profile.

1.25 The Risk Committee of the Supervisory Board should prepare the decision-making and discussions in the Supervisory Board about the bank's risk appetite and actual risk profile.

1.26 The bank's Supervisory Board, based on the preparatory work by the Risk Committee, should supervise the elaboration of the overall risk policy by the Executive Board, in particular with regard to capital allocation and liquidity requirement in accordance with the risk appetite of the institution and with regard to the observance of the limits derived from that risk appetite.

1.27 The bank's Executive Board should organise the risk management system in such a way that it has timely and ongoing knowledge of the risks run in respect of the allocated capital. Decisions that have a material impact on capital allocation and liquidity requirement in the bank, and therefore on the total risk profile, should be taken by the Executive Board and approved by the Supervisory Board. This concerns the allocation of capital to activities and geographical areas as well as to product groups.

1.28 The Supervisory Board should assess periodically whether the products carried or the client groups served by the bank are compatible with the bank's overall risk policy and nature. The Executive Board should provide the Supervisory Board with the information in such a way as to enable the latter to form a well-founded opinion on this information.

1.29 It should not be possible to market or distribute new products without the express consent of the risk management office at the bank. Risk management is responsible for the adequate operation of the Product Approval Process that every bank should have in place. Clear instructions should be issued to product and commercial managers stating that they are responsible for ensuring that the results of the Product Approval Process are respected on a permanent basis. The internal auditor should check that this is the case. The Supervisory Board's Risk Committee is kept informed at regular intervals through the internal auditor's reports.

The public role of banks

2.1 The total income of bank executives should be slightly below the median[7] of comparable positions in and outside the financial sector. Furthermore, the total income should be in reasonable proportion to the remuneration scale system at the bank. The Supervisory Board[8] assesses whether the top executives' pay is in reasonable proportion to income at lower levels, and reports accordingly to the General Meeting of Shareholders.[9]

2.2 A bank's Supervisory Board should first approve the total remuneration of the individuals in the first layer below the Executive Board, before the Executive Board actually pays them.

2.3 A bank's Supervisory Board should have an annual discussion about the highest variable incomes throughout the company, before these incomes are awarded by the Executive Board. The Supervisory Board should also discuss the retention packages and so-called 'golden hellos' awarded to this group of employees. The Supervisory Board should ensure that these income components are not excessive.

7 "Slightly below the median" is a reference to the notion that bank executives should **follow** rather than **set** the trend.
8 Where this text refers to the Supervisory Board, it is assumed that the decisions of the Supervisory Board are prepared by the Remuneration Committee.
9 Or a comparable body for legal forms other than a company.

2.4 The structure of the total income of a bank's top executives should be reflected in the structure of the rest of the income scale system.

2.5 If the award of the variable income has manifestly undesirable consequences (for instance on account of a merger, acquisition, or otherwise), a bank's Supervisory Board, in awarding the variable income, should have the discretionary power to deviate from the variable income that would have been awarded on the basis of the targets originally set. Likewise, if the ultimate payment of the variable income has manifestly undesirable consequences, the Supervisory Board should have the discretionary power to award that variable income in a different manner. In assessing these undesirable consequences, the Supervisory Board will be guided by the interests of all the stakeholders. The Board will be accountable to the General Meeting of Shareholders for its choices.

2.6 The exit provisions of the Dutch Corporate Governance Code should also be applied by banks. The so-called 'golden parachutes' should not be awarded. This means that the level of a severance payment for an executive should not exceed the fixed component of the annual salary.

2.7 A significant portion of the criteria on which the variable income for bank executives is based should consist of non-financial targets covering issues such as client satisfaction, risk management, investor relations, operating targets, human resources, integrity, compliance, sustainability, etc. Although such non-financial targets are more difficult to quantify, it is important to make these targets as objective as possible.

2.8 Financial targets that form the basis for the variable income of bank executives should be adjusted to take account of risks and capital costs.

2.9 The variable income of a bank's executives should be awarded annually based on the achievement of pre-set targets. Where the short-term variable income is concerned, the targets relate to one year. As regards the long-term variable income, the targets should cover several years. Also, the long-term component could be determined when the final award is made by taking account of the performance delivered in comparison to similar institutions.

2.10 If and insofar as the variable income of a bank's executives consists of cash, no more than one third of the amount awarded should be paid out in the award year. Two thirds or more should be reserved and paid out after a period of at least three – preferably four – years, with due observance of the provisions in recommendation 2.5. The variable income component may also consist of shares, but not of other components such as stock options. If the award is made in shares, these should be distributed after a period of at least three – preferably four – years, with due observance of the provisions in recommendation 2.5. The value of the shares ultimately to be distributed should be maximised.

2.11 In all circumstances, a prudent policy should be conducted in respect of the variable remuneration of bank executives. On an annual basis, the total variable income should equal no more than between 0% and 100% of the fixed income component. If the bank does not generate any profits, no variable income should be awarded to the Executive Board or to the next layer of management immediately below the Executive Board.

2.12 The maximum of 100% only applies to larger banks with extensive international operations, and to smaller banks that pay a relatively low fixed income component. Where the other banks are concerned, a (considerably) lower maximum percentage for the variable component will be sufficient, depending on the nature of the bank's activities.

2.13 A bank's Supervisory Board should aim to amend existing contracts as soon as possible to bring them into line with the recommendations made in this section, obviously in consultation with those involved.

2.14 Every financial institution should make a choice with regard to the most desirable shareholder structure. This structure should ensure that there is a proper balance between the interests of the shareholders and those of the other stakeholders (the clients, the employees and society as a whole). The clients' interests should be the focal point of that balance.

2.15 The Committee recommends that listed banks seek a stable group of shareholders who are willing to commit themselves to the company for a longer period. This will enable these banks to concentrate on generating added value in the longer term.

2.16 Stable bank shareholders should receive extra rewards such as a loyalty dividend distribution or increased voting rights, for example. The horizon for such stable shareholders should preferably be four years or longer.

2.17 In the interests of a meaningful dialogue between a bank and its shareholders, there should be a register of shareholders, as is the case in most of the countries of the European Union.

2.18 The issue of depositary receipts for shares in a bank may be a useful instrument to prevent a limited number of shareholders from exerting a disproportionately large influence on the General Meeting of Shareholders. To avoid a situation in which the issue of depositary receipts systematically restricts shareholders' influence, the holders of depositary receipts present or represented at the General Meeting of Shareholders should be able to exercise their voting rights at all times.

2.19 The government, the supervisors and the financial institutions in which the government recently acquired participating interests, whether as a shareholder or otherwise, should enter into consultation as soon as possible about the future shareholder structure of the institution concerned, the manner in which shares or other interests will be disposed of in the longer term and all other aspects relevant to such a disposal process.

Regulation and supervision

3.1 The entire range of supervisory measures relating to credit risk, market risk and liquidity risk needs to be reviewed. The recommendations in the Turner report[10] can serve as the basis for the review.

10 Financial Services Authority: *"The Turner Review: A Regulatory Response to the Global Banking Crisis."*

3.2 Banks should create anti-cyclical buffers. Additional provisions should be accumulated during the boom years to cover possible future bad debt during an economic downturn. These additional provisions – and any withdrawals from these provisions – would be published. Following on from the Banco De España and the recommendations of De Larosière et al, this prudent risk policy should be imposed by the supervisory authority – in this case the Dutch Central Bank. This policy of creating provisions must be accepted by the tax authorities.

3.3 The models used by banks to determine market risks need to take more account of events that are extremely unlikely but that would have a major impact if they do happen. This approach will mean that greater capital buffers are required. If the bank is unable to increase the level of capital, certain high-risk activities should be terminated. Supervisors should use their powers under Pillar 2 to impose additional – and where necessary prohibitive – capital requirements on the banks in question.

3.4 In addition to the capital requirements set by Basel II, the option of imposing a universal maximum leverage ratio on (certain types of) banks should be considered.

3.5 To the extent that banks push against the boundaries of the rules of Pillar 1, supervisors should use the powers available to them under Pillar 2 to prevent the banks from doing so by imposing additional capital requirements.

3.6 The professionalism of the supervisors must be at a high level across the board. This level of professionalism can be facilitated by more people moving from jobs with supervisory authorities to jobs with banks and vice versa, by temporary secondments in both directions and by a remuneration policy at supervisory authorities that reflects market rates.

3.7 A bank's balance sheet must always be structured in such a way as to enable government ring-fencing intervention where there is an impending crisis situation.

3.8 In an impending crisis situation, bank supervisors must have extensive powers at their disposal. The options available should include the possibility of suspending the powers of the bank's bodies (Executive Board, Supervisory Board, General Meeting of Shareholders) whilst the toxic part of the bank is removed and placed elsewhere (in a 'bad bank').

3.9 An entity should be established with the CEDS that can ensure that the agreed supervision rules are applied as far as possible in a uniform manner. In this process, uniformity must not be allowed to result in the implementation of the most lax interpretation of the regulations. Competition between supervisors ('regulatory competition') is undesirable and should be countered at all costs.

3.10 The responsibility of a national supervisory authority for the promotion of its own financial centre creates a conflict of interest with the supervisory authority's core task and should therefore not be part of the authority's mandate.

3.11 A European System of Financial Supervision (ESFS) should be established, similar to the European System of Central Banks. The primary role of the ESFS would be to provide micro-prudential supervision of those financial institutions that have substantial international activities.

3.12 The ECB's involvement in the ESRC must be firmly embedded. The ECB should provide the chairman of the ESRC and carry out the Council's operational activities.

3.13 Prior to the establishment of the ESFS, the powers of the current Level 3 Committees will need to be enhanced. The Committees will have to supervise the largest international financial institutions.

3.14 These powers can be delegated to a national supervisor or to a council of supervisors. The Level 3 Committee will act as binding mediator in the case of conflicts.

3.15 Collaboration between the ECB/ESRC and the Level 3 Committees will need to be intensified in order to facilitate optimum exchange of information between micro-prudential and macro-prudential supervisors.

3.16 In the event that there is room in due course in the run-up to European harmonisation of Deposit-guarantee schemes in 2010 for a reduction in the guarantee amount of € 100,000, any reduction must be based on the average saver. A guarantee of € 40,000 to € 50,000 would appear to be sufficient. A guarantee that also includes some level of risk on the part of the saver is not advisable.

3.17 The existing apportionment method in the Dutch Deposit-guarantee scheme should be replaced by an insurance system involving an insurance premium to be paid to the government by the banks participating in the Deposit-guarantee scheme. In the event of the Deposit-guarantee scheme being invoked, the government would pay the guaranteed sums to the savers.

3.18 The administrator of the Deposit-guarantee scheme, the Dutch Central Bank, can set conditions to be adhered to by current and new participants in the scheme.

3.19 Admission to the Deposit-guarantee scheme should be assessed separately by the Ministry of Finance when a banking licence is awarded. The Dutch Central Bank, under mandate from the insurer, can impose additional conditions on participants in the Deposit-guarantee scheme.

3.20 Banks in which the government participates and/or for which it provides a guarantee will be participants in the Deposit-guarantee scheme.

3.21 The insurance premium in the new Deposit-guarantee scheme will have to be determined at a later date, partly depending on developments at the European level.

Future of banks in the Netherlands

4.1 It is neither necessary nor desirable for the government to set up or wholly or partly own banks in order to guarantee the public service functions of banks in the Netherlands, namely payments, savings and the provision of credit.

4.2 The provision of capital market products, as long as they are of a suitable scale, should be part of the activities of the universal Dutch banks that are eligible to participate in the Dutch Deposit-guarantee scheme.

4.3 Banks that are overwhelmingly 'business banks' with a corresponding risk profile are not eligible to participate in the Dutch Deposit-guarantee scheme. This means

that limitations should be set as regards their options for attracting funds from the general public.

4.4 The banks that participate in the Deposit-guarantee scheme should strictly limit the extent to which they take any counterparty risk (including any potential risk) as regards financial institutions that are not part of the Deposit-guarantee scheme.

Restoring trust

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Annex 2

List of international reports published about the credit crunch

March 2007
Institute for International Finance:
"Principles of Liquidity Risk Management."

March 2008
Senior Supervisors Group:
"Observations on Risk Management Practices During the Recent Market Turbulence."

April 2008
Financial Stability Forum:
"Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience."

July 2008
Institute for International Finance:
"Final Report of the IFF Committee on Market Best Practices: Principles of Conduct and Best Practice Recommendations."

August 2008
Counterparty Risk Management Group:
"Containing Systemic Risk: The Road to Reform."

September 2008
Basel Committee on Banking Supervision:
"Principles for Sound Liquidity Risk Management and Supervision."

October 2008
Report of the Financial Stability Forum:
"Enhancing Market and Institutional Resilience Follow-up on Implementation."

January 2009
Basel Committee on Banking Supervision:
"Revisions to the Basel II Market Risk Framework."

February 2009
De Larosière Group:
"The High-Level Group on Financial Supervision in the EU."

March 2009
Financial Services Authority:
"The Turner Review: A Regulatory Response to the Global Banking Crisis."

European Commission:
"Communication for the Spring European Council: Driving European recovery."

Annex 3

Advisory Committee on the Future of Banks in the Netherlands

Cees Maas, Chairman

- *Former Vice-Chairman and CFO of the Executive Board of the ING Group.*
- *Former Treasurer at the Dutch Ministry of Finance.*

Sylvester Eijffinger

- *Professor of Financial Economics and member of the Board of the European Banking Centre at Tilburg University.*
- *Member of the European Parliament's Monetary Experts Panel.*

Wim van den Goorbergh

- *Former Vice-Chairman and CFO of the Executive Board of Rabobank Nederland.*
- *Former Chairman of the Netherlands Bankers' Association.*

Tom de Swaan

- *Former member of the Executive Board and CFO of ABN AMRO.*
- *Former Director of Supervision at the Dutch Central Bank.*

Johanneke Weitjens, Secretary

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