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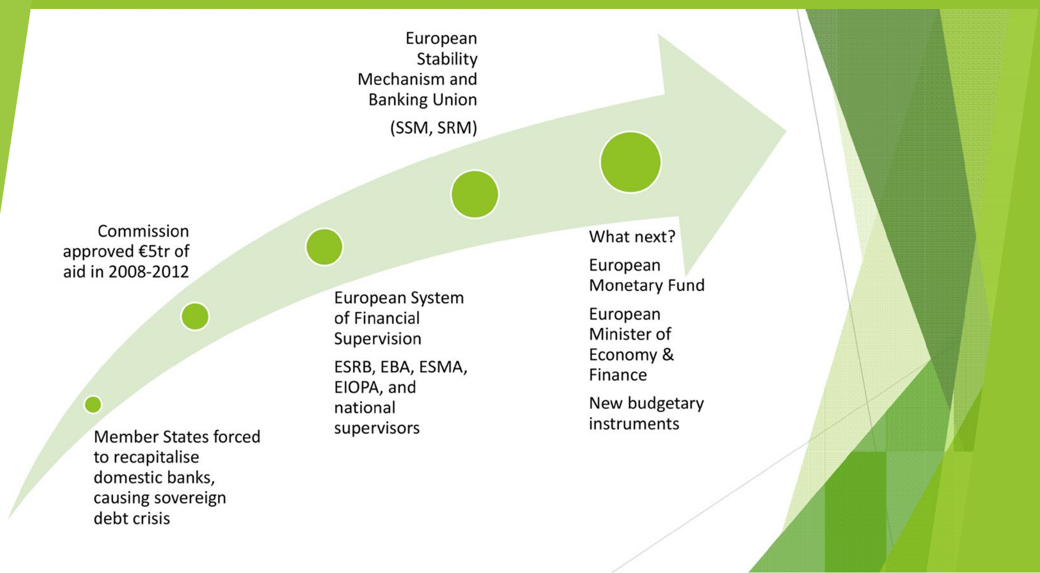

We provide for the EU system an analysis that is independent and hopefully of expert value. And that should inform policy discussions.

PRODUCTION

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From 'too big to fail' to 'too big to audit'?

Back in 2004, at a time when I was involved in ECA audits on EU banking, lending and borrowing, I attended a training course in Maastricht on banking issues. From this course, I recall very vividly the statement made by one of the key speakers, a vice president of one of the major commercial banks in the EU: "The larger the bank, the bigger the risk appetite." Elaborating further on this issue with him, the 'too big to fail' concept in banking – and its perverse effects – became clear to me. Memories of this seminar came flooding back with a vengeance in 2008 when the financial and economic crisis hit the EU and its Member States.

Since then, the EU has armoured itself against the devastating consequences that an uncontrolled 'too big to fail' had on the lives of millions of EU citizens. The steps taken have been impressive: they comprise measures to prevent not only a banking crisis, but also a sovereign debt crisis, a euro crisis and even a major economic crisis. Since 2009, numerous mechanisms, often embedded in new or existing institutions, have been created for monitoring, supervision and support purposes; these include many measures to mitigate systemic risks in finance and banking in the EU. They have curious names like 'Two pack', 'Six pack', or the 'Banking Union', and an even larger number of peculiar acronyms, such as EDP, EMU, SSM, SRB, EBA, ESMA, etc. The ECA has also created an acronym for its own contribution to this end: FEG, which stands for 'Financial and Economic Governance'.

With new EU actions to regulate and supervise, it became clear to the ECA that it would also have to get involved; not only because EU funds were being used and put at risk, or because of the many actions arising from the new roles taken up by the European Commission and many newly created EU bodies, but also because people would eventually ask: Has it all helped? Has it been effective? These are important questions to answer, because public confidence in banking and finance – but also in public government – was falling to an all-time low – so much so that this was even being talked about as a 'crisis of confidence'. This was a daunting task for the ECA, then, firstly because of the many measures taken and the barriers to accountability identified, but also because of the inherent difficulty in predicting whether the measures currently in place will prevent another crisis from happening. Perhaps they have already been successful in doing so; however, the fact that there has not been another crisis does not necessarily imply that the measures taken were effective.

Financial and economic governance is the main theme of this month's Journal, which provides insights into how the ECA took up the task of auditing the plethora of EU measures in this area. This month's issue includes interviews with ECA Members Baudilio Tomé and Kevin Cardiff (see pages 5 and 66), articles on how the FEG team came into being (see pages 13 and 18), coverage of the three main strands of the ECA's audit work (see pages 23 to 38) and views of experts in the field and readers of our reports (see pages 39 to 49). We also present some prospects for future developments in this area (see pages 50 to 65).

By selecting FEG as this month's main theme, we are also aiming to reach readers who are less familiar with the topic, due to its technical appearance, its intrinsic jargon or its multi-faceted and thus inscrutable framework. Herein lies one of the ECA's core objectives in doing work in this area: to make clear, comprehensible and more transparent for EU citizens what has been done to date and to facilitate public scrutiny through evidence-based reports. Since 2014, the ECA has published around a dozen audit reports on financial and economic governance issues.

In fact, the sheer size of the topic, its complexity and its specialist nature have not deterred us from auditing this particular area, but are rather additional reasons to do so. Rather than being 'too big to audit,' it is the fact that this area is 'too big not to audit' – given the potential impact for EU citizens – that has been an important driver for the ECA to step into an area where the word 'trust' has many dimensions and implications, not only financial ones. And since trust is a key element in public audit, the ECA is well placed to contribute.

Gaston Moonen

Baudilio Tomé Muguruza, ECA Member

ECA reports on financial and economic governance: providing added value in a new audit area

Interview with Baudilio Tomé Muguruza, ECA Member

By Gaston Moonen, Directorate of the Presidency

As Dean of Chamber IV on Regulation of markets and competitive economy, Baudilio Tomé has been pivotal in proposing and leading audits on financial and economic governance issues. He shares his thoughts about the why, what and how of the ECA's work in this area till now and his expectations for the future.

Crisis responses posing urgent challenges for EU institutions, including the ECA

Speaking with Baudilio Tomé about the Union's activities in the financial economic governance area is easy, also due to the relaxed atmosphere in which it takes place. He remarks jokingly: 'An interview can be a good exercise to prepare for a presentation I have to give next week in parliament.' He is eager to talk about the ECA's work in an area he is not only very familiar with, but where he was also a key player in proposing and leading audits. He clearly is proud of what the ECA has produced so far: 'The financial and economic crisis that started ten years ago was a challenge for everybody: for Member States which needed to mobilise significant financial resources to counter the immediate effects of the crisis in a very short time. But also for European authorities: for the European Commission that had to enter into new activities, ranging from running macroeconomic assistance programmes to running the new surveillance systems put in place, for the ECA but also for the European Central Bank (ECB), with mechanisms like the European Semester, the Excessive Deficit Procedure and the Macro-economic Imbalance Procedure.' He also refers to the new regulatory agencies that have since been established in the financial sector on insurance, banking, pensions and markets. 'With all these measures taken the crisis also became a challenge for the ECA. Not only because the role of the Commission evolved and new agencies were established which the ECA had to audit. But foremost because public money was at risk, both EU and national, and on a larger scale. And in different ways than before.'

For Baudilio Tomé it was clear that the ECA had to adapt to this new environment: '. The euro is one of the major European achievements, with a long and difficult road to it. But we can be proud to share this currency, which will hopefully keep Europe united for the future. The crisis showed, however, that there were very significant weaknesses in the original design and governance arrangements of the euro. And this is what the EU addressed: many reforms were implemented, and more reforms are planned, as we can see in the Commission's reflection paper on deepening and completing the Economic and Monetary Union.' He hopes that the European Parliament and the Council will soon consider these reform proposals: 'In the end it is for the political leaders to decide among the different alternatives. But for the ECA the task is to be ready to do our work to assess whether all these new procedures are well implemented, have proper accountability arrangements and lead to the results for which they were created.'

> *In the end it is for the political leaders to decide among the different alternatives. But for the ECA the task is to be ready to do our work to assess ...*

A dozen ECA reports presented on financial and economic governance topics

Baudilio Tomé thinks the ECA has been reasonably successful in covering the domain of financial and economic governance until now. 'We have presented about a dozen reports so far, covering almost all the new surveillance procedures including the European Semester. When publishing the results of our audit on the European Insurance and Occupational Pension Authority (EIOPA) later this year the ECA will also have covered all regulatory and surveillance agencies in the financial sector. And the ECA has done very relevant work concerning the Banking Union with the two reports recently published on the Single Supervisory Mechanism and the Single Resolution Mechanism.' He adds that the ECA has also produced several reports on the management of the economic support programmes, like financial assistance provided to countries like Portugal and Ireland, but also to Romania, Latvia and Hungary. 'And we did two reports on the Greek crisis: one regarding the task force for Greece and one on the Greek financial assistance programme.'

He brings up an aspect he believes to be very important to add value: 'We audited all these procedures, agencies and new responsibilities at an early stage, when they had just been established. We then pointed out weaknesses in design of procedures and processes and we contributed with relevant recommendations.' He highlights that the auditees accepted most of the ECA recommendations, which made it possible to make an early start with improvements in many areas.

Professional career in public finance

As reporting Member for several audit tasks in the financial economic governance area, Baudilio Tomé was directly involved in four reports: the two reports regarding Greece (Special Reports 19/2015 and 17/2017), the report on assistance to countries in difficulties (Special Report 18/2015), and the Special Report 22/2015 on European Securities and Market Authority (ESMA). Before he joined the ECA in 2012, he was a Member of Parliament in Spain. The public finance area is not new to him, on the contrary: 'Public finance has been my life! I have been in public service my whole professional career.' He worked for the Spanish Ministry of Finance, as Chief Economic Advisor to the Spanish Prime Minister, and as Director for the Office of the Budget in the Spanish Prime Minister's Office. 'But,' he adds, 'here at the ECA Members do not necessarily serve in the area in which they are experts or feel most comfortable with. We are here to serve the ECA, appointed to take responsibility for this EU institution as a whole.'

> *Public finance has been my life!*

Looking back at his early years at the ECA, Baudilio Tomé observes: 'We all realised at that time that we were not well equipped to address the new challenges arising from the economic and financial crisis. But like other institutions we adapted, we had to if we wanted to be relevant. The Financial Economic Governance (FEG) team was established and the way it was done was a kind of precedent of the ECA-wide organisational reform in 2015 towards a task-based organisation. A clear need to build up new capacity was identified and this had to be done in a short period of time. We called and searched for auditors within the house with an appropriate background; new staff with desired qualifications and expertise were hired; and we drew on external advice – through seminars and talking to external practitioners, also for defining our new role.' He adds that the ECA also called in the help of external experts in these new domains, 'And it worked because we were able to deliver. Through the process of building up the FEG capacity we also contributed to the wider transformation of our organisation. Now, with the current ECA programming system, we concentrate more than before on the real priorities and then look at the best way to achieve them, requiring flexibility in our institution for the allocation of resources. I believe this approach helps the ECA to stay relevant not only in the financial and economic governance area.'

> *But like other institutions we adapted, we had to if we wanted to be relevant.*

Need for embedded accountability arrangements

Baudilio Tomé underlines that there is a common thread in all these reports: through its work the ECA contributes to create transparency for institutional stakeholders and the public at large how these new procedures and agencies operate and what aspects could be further improved. 'But all these new procedures have to have proper accountability arrangements embedded in them. This is one of the major difficulties we have seen in our work.' Several of these gaps were already identified in the 2014 ECA landscape review on EU accountability and public audit arrangements. He emphasises that the audit gaps the ECA identified are real and pertinent: 'Look at for example the difficulties we faced when auditing the ECB. This is a serious matter which needs to be addressed.'

> *But all these new procedures have to have proper accountability arrangements embedded in them.*

According to Baudilio Tomé, the current situation is also a consequence of the way the reaction to the crisis was organised within the EU: 'Sometimes the reaction was through intergovernmental solutions, then through creating international organisations. If there is a conclusion to be made it is that full accountability should be an aspiration.'

Adequate safeguards against a new crisis?

Speaking about the lessons learnt brings up another question that underlies all the efforts made: could it happen again? Baudilio Tomé laughs and makes clear that the future is not written and depends on many different things. 'But I do believe that the EU is now in a much stronger position than at the start of the crisis. Many things have changed both at national and EU level regarding banking regulation, banking surveillance and macro-economic surveillance. Definitely the EU is in a much stronger position to resist a crisis.' He underlines that the Banking Union is not completed yet. 'I believe, however, that the most important lesson we can draw is that the answers have to be European. There is a need for a strong, consistent, transparent and accountable set of EU institutions.'

Many measures have been taken to prevent financial risks materialising as they did ten years ago. But how can you transfer this information to the European citizen in a way that they can be confident about the safeguards created? Baudilio Tomé has a strong view on that: 'I think we all should make an effort to confront populism. Populism is about trying to undermine the confidence citizens have in our institutions, the political process, the constitutional process, important cornerstones that made our free societies work. And this is part of our role as the ECA: to show people that they can rely on the EU and its institutions since weaknesses will be found and addressed.' He concludes that simplification is often aspired to but that there will always be complicated issues to address: 'What is needed in a complex world is trust in institutions and the rule of law.. And this is precisely what populists try to undermine.'

Looking forward he expects the ECA to produce a new landscape review. 'The landscape review of 2014 was an important contribution to the discussion on accountability gaps within the EU. I think that a landscape review on economic and financial crisis management, bringing together all our findings in the area of economic and financial governance, could be very helpful for making the case for stronger accountability in this area. Such a landscape review could also discuss the changes that have been introduced in this domain during the last years. It would however need to be ready in time when legislative proposals for completion of the Economic and Banking Union are going to be discussed to call the attention of the decision makers on these very important issues.'

Increasing added value for the future

Reflecting on the impact of the dozen ECA reports, Baudilio Tomé believes these brought transparency on how the challenges were taken up and related programmes and agencies were established: 'I think that the Commission is now much better equipped and organised

> *... I do believe that the EU is now in a much stronger position than at the start of the crisis.*

> *... the most important lesson we can draw is that the answers have to be European.*

> *What you need in a complex world is trust in institutions, the rule of law, the arrangements put in place. And this is precisely what populists try to undermine.*

than it was at the beginning of the crisis. Experiences have been taken into account for subsequent solutions and institutional arrangements are agreed upon. And our conclusions in relation to procedures and processes will be valid even when new institutions, perhaps for European fiscal capabilities, will be build.' As for the future Baudilio underlines that there is a consensus in the ECA that the focus of our work should be on performance aspects, as is also reflected in the ECA 2018-2020 strategy which had been adopted in 2017: 'Performance should be the focus. This is definitely the direction the ECA wants to follow and what our stakeholders demand.'

He also thinks the ECA has to aspire to be more visible at the European Parliament: 'Our reports should be taken into account in any relevant discussion where European policy-related issues are concerned. Our reports are now discussed in many more committees of the European Parliament than in the past, but we can still do better, including for the EP's Committee on Economic and Monetary Affairs'. He adds, 'Financial and compliance audit will always be our core business and our main obligation under the Treaty, but the more we deliver on performance-related issues the more relevant we will be. Baudilio Tomé finds it important that ECA reports are welcomed by Members of Parliament from across the political spectrum as objective and impartial evidence: 'We bring professional opinions, based on evidence we have access to.'

... the more we deliver on performance-related issues the more relevant we will be.

The recent global financial crisis and sovereign debt crisis

By Simon Dennett, Private Office of Baudilio Tomé Muguruza, ECA Member

Since the global financial crisis and the ensuing sovereign debt crisis, the EU has devoted considerable efforts into reacting to the immediate crisis and building a new framework to stave off future disasters. It has come to dominate agendas across the continent, and is regularly found atop newsreels as another facet of the situation comes to light. Simon Dennett goes back to the crisis origins and main measures taken at the European level.

Old story revisited

In by what is now a well-told story, a combination of excessive risk-taking and adverse developments in the financial markets resulted in a global crisis affecting Europe in 2008. Banks were no longer able to seek finance on the markets, and further, each institution was so closely intertwined with others that the failure of one endangered the other. As some analyist described it, soon the 'belief that certain organisations were 'too big to fail' vanished'[1] . With modern financial systems as they are, the mounting problems quickly spilled over borders and exacerbated fragilities in the Economic and Monetary Union (EMU) architecture, exposing the banks and the sovereigns as too closely interlinked.

The EU and its Member States were forced into a choice: to let banks collapse with their citizens' savings or intervene by recapitalising the banks at enormous cost to prevent their collapse and stabilise the financial system. The reversal of the massive, boom time cross-border capital flows, triggered by the global financial crisis meant there was, in reality, little choice.[2] However, by bailing out their banks, the governments of Europe put themselves under enormous financial strain, which panicked the markets as their debt rose dramatically. This, in turn, prompting a sovereign debt crisis.

Numerous European economies were plunged into recession and the insufficiency of Europe's regulatory framework was exposed. It also drew attention to the negative credit quality of many banks and states' bonds and, until then, the barely regulated activities of credit ratings agencies.

As the ECA described in its Special Report 18/2015 regarding financial crisis assistance provided to a number of Member States, the crisis swept across EU Member States in waves, first affecting the non-euro area countries in 2008-2009 and later spreading to the euro area itself. The first wave, affecting non-euro area countries forced Hungary, Latvia and Romania to seek assistance from the EU's balance of payments mechanism and the International Monetary Fund (IMF). The second caused sovereign bond ratings to decrease and interest to increase, meaning Ireland and Portugal and others had to apply for financial assistance.

1 See for example Drudi, F., Durré, A. and Mongelli, F. P.(2012) 'The interplay of economic reformsand monetary policy: The case of the Eurozone', Journal of Common Market Studies, Vol. 50, No. 6, pp. 881–898.

2 'A disagreement in Europe: The euro crisis was not a government-debt crisis' (2015, 23rd November) The Economist https://www.economist.com/blogs/freeexchange/2015/11/disagreement-europe

European level responses

In response, the European Commission approved over € 5tr[3] of aid during the five years between 2008 and 2012, which was designed to help countries repay or finance their maturing debt and deficits, restore their capacity to meet their public-sector (euro area) or balance-of-payments (non-euro area) obligations.[4] Several instruments were created to help the EU provide and organise all this financial assistance. There already existed a balance-of-payments mechanism for non-Eurozone countries, and this was added to by the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF). These were subsumed into the European Stability Mechanism (ESM) in 2012. The EU also undertook a raft of regulatory and supervisory reforms looking ahead, to prevent future crises of this nature, under the European System of Financial Supervision (ESFS) umbrella.[5]

The process of reform had in fact been slowly in train for some time before the crash struck. The European Parliament had long been calling for 'more integrated European supervision in order to ensure a true level playing field for all actors…and to reflect the increasing integration of financial markets in the Union.'[6] Integration of the markets for financial services and their deregulation in the EU has been fast, but supervision of banks' activities had until then been restricted to national borders. However, the previous system was not able to sufficiently cover the risks of cross-border banking, as was noted in the De Larosière report of 2009, titled 'report of the High-Level Group on Financial Supervision in the EU.' Therefore, in 2011 EBA was set up to strengthen the regulatory framework and the supervision of banks.

Regarding credit rating agencies (CRAs) it was the crisis that prompted the realisation that reform was needed. Before 2007 regulators everywhere relied on credit ratings agencies, but they were almost unregulated, running mainly on the best practices of the International Organisation of Securities Commissions. The European Commission saw fit to only lightly regulate the CRAs in combination with self-regulation, focusing on a few specific areas such as insider trading and market manipulation.[7] The harsh realities of the 2008 financial crisis changed all that. By November of that year, the Commission had proposed to regulate the CRAs. The following regulation forced CRAs to: register with a national supervisor; disclose models, methodologies and assumptions; and be subject to supervision by national regulators. The De Larosière report of 2009, made in the run-up to the regulation in early 2009, suggested further reform by conferring registration and supervision duties to the EU level. As a result, the European Securities and Markets Authority (ESMA) was established in 2011 as well to "protect public interest by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets" (Special Report 22/2015). Within six months of its establishment it was given exclusive supervisory powers over CRA registration in the EU. And in May 2013 another amendment was approved with the aim of reducing reliance on credit ratings and improving EU Member States' sovereign debt ratings.

By 2012, to break the damaging link between states and the banks, or the so-called 'doom loop', the first steps had been taken towards European banking union, to make European banks more transparent, unified, and safer. The first pillar of this was the Single Supervisory Mechanism (SSM), which was approved in October 2013, to guarantee the consistent

3 This amounted to 40.3% of EU GDP (COM(2012) 778 Final of 21 December 2012 and SWD(2012) 443 Final of 21 December p29).

4 see also ECA Special Report 18/2015 on financial assistance provided to countries in difficulties.

5 Under the umbrella are the: European Banking Authority (EBA); European Securities and Markets Authority (ESMA); European Systemic Risk Board (ESRB); and European Insurance and Occupational Pensions Authority (EIOPA).

6 European Union (2010) 'Regulation No. 1093/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority), amending Decision No.716/2009/EC and repealing Commission Decision 2009/78/EC', Official Journal of the European Union, 24th November, L331/12-47 2010.

7 Communication from the Commission on Credit Rating Agencies (OJ C 59, 11.3.2006, p.2).

application of prudential rules – to improve financial condition of credit institutions – across the Eurozone, based on the EU Single Rulebook. This phase of banking union gave the European Central Bank (ECB) power to supervise the banking sector in close cooperation with the national authorities. Essentially the ECB now has direct oversight of the most important banks in the Eurozone. The second pillar of the banking union is the Single Resolution Mechanism, which since its establishment in 2014, has responsibility for dealing with failing banks in the Euro area, with decisions taken by the Single Resolution Board.

Continuing the reform process

Looking forwards, the Commission has made a series of reform proposals in recent months with the aim of bringing about the completion of the banking union. The most eye-catching proposal is an extension of the current European Stability Mechanism (ESM) into a European Monetary Fund (EMF). Equipped with a lending capacity of €500m, it would provide financial assistance to countries in need and act as a common 'last resort backstop' to the euro area to provide a safety net in cases where the Single Resolution Fund cannot cope. Other proposals include the creation of a European Minister of Economy and Finance, where the Minister would be a member of the Commission, President of the Eurogroup, and also chair of the proposed EMF. The Commission has also proposed several new budgetary instruments for the Euro area, including: a 'reform delivery tool' to help spur Member States into enacting reforms that improve the resilience of their economies; a 'stabilisation function' that would offer support to help maintain the flow of investment in priorities and projects at the national level in the event of a crisis; and the extension of the Structural Reform Support Service in light of a greater than expected volume of requests from Member States.

Source ECA

ECA role to play

While Europe's leaders should easily agree with the Commission's initiative that 'the roof should be fixed while the sun is shining', the shape it will take, including the role of the European Court of Auditors, is yet to be defined. The challenge for the ECA is to keep pace with the myriad responses and developments. Considering that hundreds of billions have already been spent, it is vital that we continue to carefully assess the measures taken to date, and devise new ways in which to carry out our duty as the guardians of the EU's finances to help Europe be better prepared the next time problems occur in the financial sector.

The ECA's approach to auditing EU economic governance issues

By Matthias Blaas, Directorate Regulation of Markets and Competitive Economy

In response to the financial and economic crisis, a set of measures was taken to repair the EU's financial and economic structure and shield it against future systemic risks. What consequences did the many measures taken at the EU level have on the ECA's audit work? Matthias Blaas fills us in on how the ECA rose to meet the new audit challenges emerging in the field of financial and economic governance.

Setting the scene: What is European financial and economic governance?

After the financial crisis in 2008, the European legislator identified several weaknesses in European financial and economic governance. Key deficiencies detected were poor supervision of financial markets, too-big-to-fail banks, weak fiscal policies and a lack of preparation to provide financial assistance. These issues were addressed through the creation of new policies and new EU authorities.

Economic governance

After the bailout of financial institutions to prevent the financial markets from collapsing, the financial crisis triggered a sovereign crisis and ensuing turmoil on sovereign debt markets. Thus, in the area of economic governance, it became clear that the arrangements made in the Stability and Growth Pact had not been sufficient to guarantee economic stability. The EU established a task force, which issued a final report in October 2010[1]. Based on this report, in 2011 the EU decided to improve its economic governance to *"strengthen the economic pillar of the economic and monetary union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact, to strengthen the coordination of their economic policies and to improve the governance of the euro area"*[2]. It reformed the Stability and Growth Pact and its excessive deficit procedure, and also introduced the macroeconomic imbalance procedure and the European Semester.

Assistance to Member States

The sovereign crisis first affected non-euro area countries and later spread to the euro area. Due to escalating debt levels and uncertainty, credit rating agencies started to downgrade sovereign bonds, pushing sovereign bond market interest rates significantly higher. As a result, eight EU Member States were forced to seek external financial assistance to finance maturing debt. This assistance aimed to safeguard the stability of the euro area as a whole and restore the macroeconomic and financial health of the EU Member States concerned. Different countries used different tools, such as the balance-of-payments mechanism or the European Financial Stabilisation Mechanism. In addition, the European Financial Stability Facility was established. The European Commission and the International Monetary Fund managed the crisis in non-euro area countries, while the European Central Bank (ECB) was also involved in managing financial assistance in the euro area.

Financial supervision at EU level

In the area of financial governance, the EU established a high-level group on financial supervision, chaired by Jacques de Larosière, which published a report in February 2009[3].

1 Report by the Task Force to the European Council on strengthening economic governance in the EU (21 October 2010).

2 Art. 1 (1) Treaty on Stability, Coordination and Governance in the EMU (TSCG)

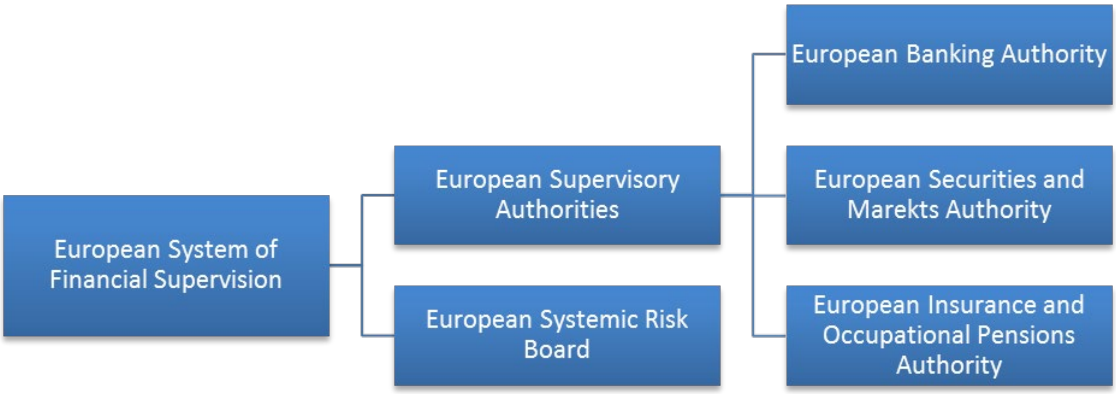
3 Report of the high-level group on financial supervision, chaired by Jacques de Larosière, February 2009.

Based on this report, the legislators decided to set up a European System of Financial Supervision (ESFS). It encompassed three new European Supervisory Authorities (ESAs) and a European Systemic Risk Board (ESRB). The ESAs were given several tasks to ensure good and convergent micro-prudential supervision in their respective fields of expertise. The ESRB was established as a macroprudential supervisor under the auspices of the ECB. It would identify, prevent and mitigate systemic risks. Together these bodies would ensure the financial stability and proper functioning of the EU's financial markets.

The three new ESAs were formed as independent EU agencies of existing committees:

- the European Banking Authority;
- the European Securities and Markets Authority;
- the European Insurance and Occupational Pensions Authority.

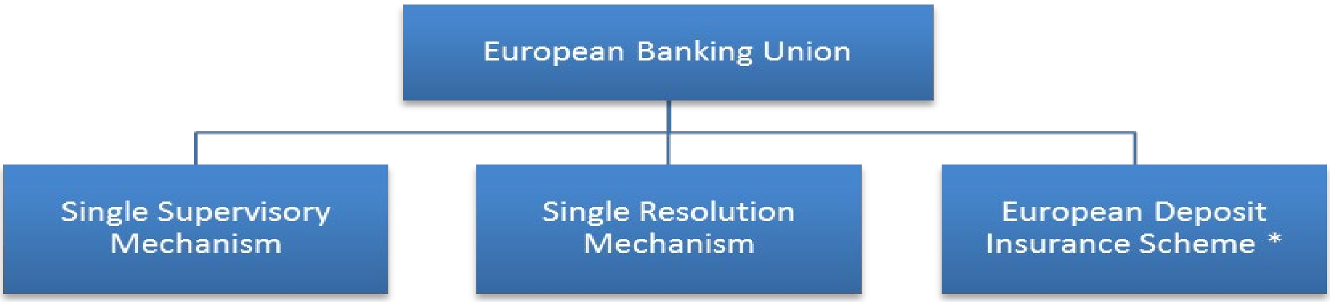
Figure 1: The set-up of the European System of Financial Supervision; Source: ECA



Banking Union

The necessary bailouts of euro area banks during the financial crisis proved that there was a strong banks-to-sovereign link. One key problem was that many banks were considered "too big to fail", since their failure would have endangered the financial system and threatened serious contagion effects. To strengthen the supervision of large and complex banks, the legislator decided to create a European Banking Union. This consists of the Single Supervisory Mechanism (SSM), which was set up in 2013, and the Single Resolution Mechanism (SRM), which was set up in 2015. The SSM is responsible for directly supervising the most significant banks within the euro area. It was established under the umbrella of the ECB. The SRM, with the Single Resolution Board (SRB) at its heart, is responsible for preparing resolution plans and for resolving failing banks. The SRB also manages the Single Resolution Fund (SRF), which is funded by the banking industry and can be used for difficult resolutions. This is intended to solve the too-big-to-fail problem. A European Deposit Insurance Scheme has been proposed as a possible third pillar of the Banking Union, but this is still under discussion. It would guarantee deposits within the euro area of up to €100 000 per person, as is currently done by national deposit guarantee schemes.

Figure 2: The three pillars of the European Banking Union; *under development; Source: ECA



What made European financial and economic governance such an important area?

The European Court of Auditors (ECA) soon realised that although most of the changes and activities occurring at EU level did not directly impact the EU budget (or required only limited funding), they would have a huge socio-economic impact and were critical for fiscal and budgetary policy in Member States. Additionally, this complex, multi-party, multi-layered system of financial and economic governance structures required a much higher level of public audit and democratic accountability.

Therefore, the ECA initiated a Landscape Review, which was published in 2014.[4] The Landscape Review uncovered several issues relating to financial and economic governance. On the one hand, an evolving number of EU bodies with different governance, accountability and audit arrangements might lead to disproportionate levels of scrutiny, gaps and overlaps – all the more so given the lack of transparency. On the other hand, several bodies were designed on an intergovernmental basis, for example the European Investment Bank and the European Stability Mechanism. Nevertheless, they require comprehensive democratic scrutiny and an appropriate level of public audit.

The ECA's answer: A special project team for financial and economic governance

The risk that certain EU entities would fail to perform their responsibilities in the area of financial and economic governance was a risk to the EU and all Member States' public finances. It therefore warranted special attention from the ECA. In 2013, the ECA decided to set up a special project team to audit EU financial and economic governance. The team of experts was set up within the audit chamber responsible for the regulation of markets and competitive economy. The Members of this audit chamber selected Zacharias Kolias to build, coordinate and lead this team.

The team, also known as the 'FEG team', started with a selection of 11 in-house auditors chosen on account of their knowledge and skills in areas such as financial supervision, econometrics, statistics and financial markets. This team was given various specialist training sessions in preparation for its new tasks. Over the past four years, the ECA has complemented its internal expertise by adding several further experts via recruitments and secondments from national authorities.

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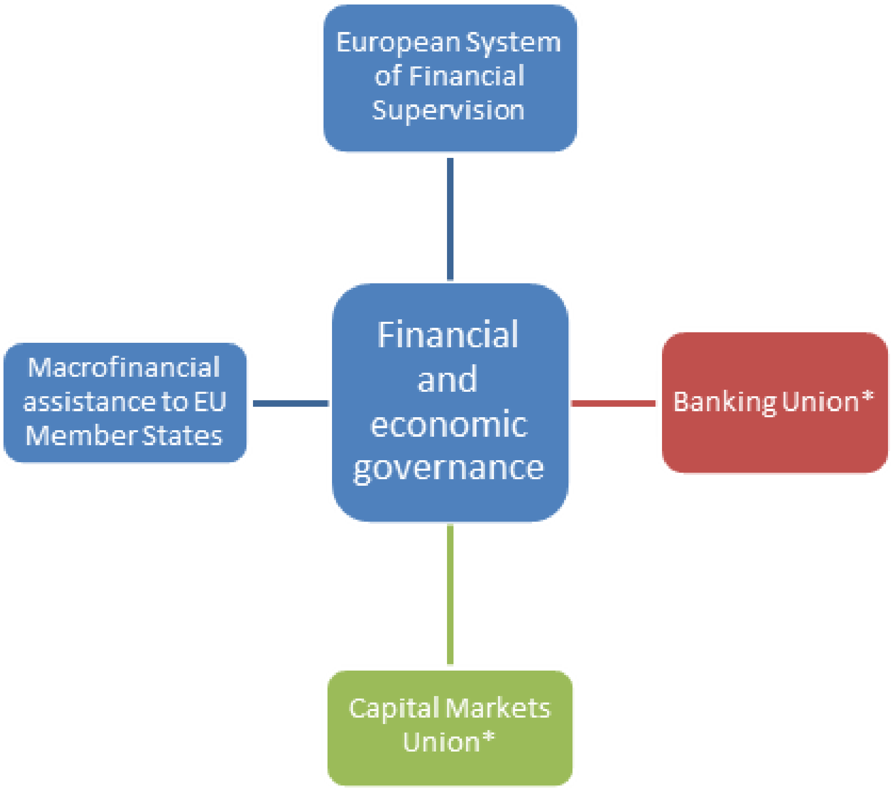
4 Gaps, overlaps and challenges: a landscape review of EU accountability and public audit arrangements (2014)

The FEG team was made responsible for audits on:

- economic governance arrangements including, for instance, the Stability and Growth Pact and the European Semester;
- macrofinancial assistance provided to EU Member States, including the underlying statistics;
- the ESFS and all its evolving tasks, including the Capital Markets Union;
- the European Banking Union, including bank resolutions and state aid for financial institutions;
- all other developments related to the European Monetary Union

Figure 3: Topics within the area of Financial and Economic Governance nowadays; *under development; Source: ECA



Finding ways to ensure accountability

Since the FEG team began its work, the area has continued to develop. When the legislator decided to set up the SRB in 2014, it assigned the ECA additional responsibilities. The ECA is now responsible for assessing whether any use of the new SRF is economic, efficient and effective and if the amounts used have been kept to a minimum.[5] In response, the ECA decided to set up a bank resolution contingency audit team (BRCAT). This team comprises ten auditors from across the ECA with relevant experience in banking. They received a number of specialist training sessions in recent years. Experts from the FEG team manage the BRCAT. The BRCAT equips the ECA with the necessary expert capacity to audit any use of the SRF. This is especially important in the event of a resolution of a large bank.

5 Art. 92 (2) Regulation (EU) 806/2014

The ECA's role of ensuring adequate accountability is particularly crucial in the area of financial and economic governance because the sub-areas:

- are very technical and complex in nature;
- can have a huge impact on public finances;
- lack transparency;
- leave the relevant authorities a high degree of discretion based on expert judgement.

With the new contingency team responsible for bank resolution audits and the expertise assembled in the FEG team, the ECA believes it is as well prepared as it can be to audit financial and economic governance at EU level. However, as some of the figures above show, this area is in constant development. Thus, a need for new expertise might soon arise. In a worst case scenario, a fresh crisis may appear, calling for novel solutions to ensure public audit and democratic accountability for EU action undertaken.

Untill recently carrying out audits of financial and economic governance issues were new on the ECA's horizon. Mirko Gottman provides insights on what he calls 'Starship FEG.'

Voyagers of 'Starship FEG': a journey into the domain of the EU's financial and economic governance

By Mirko Gottman, Directorate Regulation of markets and competitive economy

'Starship FEG'

Space, the final frontier. These are the voyages of the Financial and Economic Governance (FEG) team at the European Court of Auditors (ECA). Its mission: to explore new audit fields, to boldly go where no audit team has gone before.

Planning the destination

In the financial and economic governance area, as in other areas where EU policy is implemented primarily through regulatory action, potential audit tasks are selected on the basis of the overall socio-economic impact of a specific policy (rather than the amount of funding from the EU budget). For instance, the funds earmarked by the Commission to implement the Greek adjustment programme amounted to only a few million euros. At the same time, the overall financial support disbursed to the Greek government was more than 240 billion euros. The same applies to banking supervision where the annual budget of the European Central Bank (ECB) is around € 500 million. The overall assets supervised however, amount to € 26 trillion – about 2.6 times the Euro-area Gross Domestic Product (GDP). In other words, the socio-economic impact of these policies is significantly higher than that of any EU or national spending programme.

... the socio-economic impact of these policies is significantly higher than that of any EU or national spending programme.

Getting ready for take-off

When planning our audits we faced the challenge of striking a balance between feasibility and coverage of a domain. Discussions about the correct scope of the audit were often intense, but always constructive.

From a methodological point of view, another key success factor at the planning stage was to select only those policy conditions that had to be met prior to the disbursement of funds which were also auditable. This was the case for three of the audits undertaken; two on the Greek adjustment programme and the other on the EU's financial assistance to countries in economic and financial difficulties. Otherwise, we would have run the risk of getting lost in space. This required building up the necessary in-house expertise and close interaction with our auditees to learn from them which aspects matter most for these policies to be effective.

Recruiting the crew

Getting ready to carry out audits in this field was also a bit like working in a start-up. A key challenge in the early stages of the FEG was to find staff with the required technical knowledge. We organised an internal call for expression of interest and recruited external experts as well as temporary officials and seconded national experts as team members. This insourcing of expertise was complemented by sustained and specialised training measures for staff. Some of the audit tasks required the management of large teams simultaneously working on different tasks (for example for auditing the Greek adjustment programme or the European Semester).

As a result, while 'Starship FEG' has a crew with diverse backgrounds, all team members are by now experienced and versatile auditors in the field of financial and economic governance issues. This expertise must now be sustained, particularly in view of the ECA's new audit obligations under Article 92 of the Single Resolution Mechanism Regulation (Regulation 806/2014 of 15 July 2014).

> *... Starship FEG' has a crew with diverse backgrounds ...*

Landing on (un)chartered territory

We learned that each audit in this new area was one of a kind, and that technically skilled and flexible people with a high level of dedication were needed to perform the tasks. In some cases during the audits it turned out that the area was much broader or more complex than originally anticipated. Occasionally, audit tasks were split into two reports (e. g. Greek adjustment programme, European Semester).

A key issue during some of the audits were restrictions on access to documents. For the Greek adjustment program audits, the ECB refused to provide evidence on its role and work in the programme. Difficulties were also encountered (but ultimately solved) with the International Monetary Fund (IMF) when collecting the underlying documentation. For the audit of banking supervision our auditors did not obtain access to critical documents and a similar situation arose during our audit of the Single Resolution Board.

> *... Starship FEG' landed successfully and auditing the EU's financial and economic governance arrangements is no longer uncharted territory.*

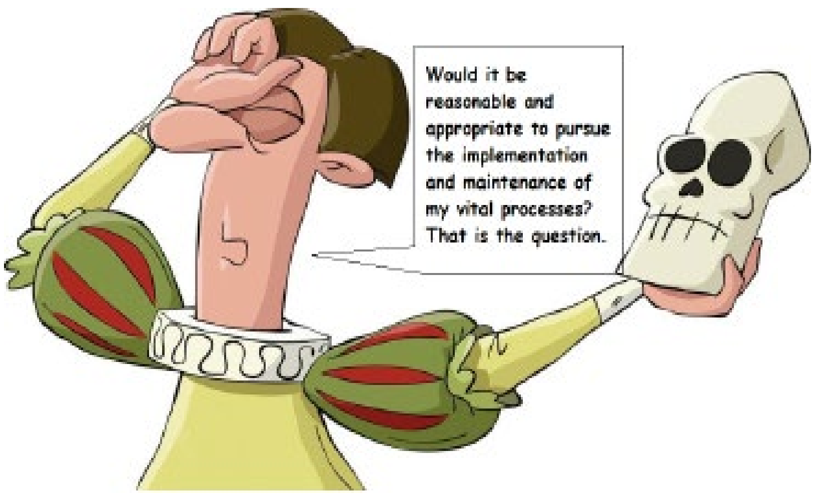
This also required flexibility from the audit chamber and a need to plan time for such contingencies. But in the end 'Starship FEG' landed successfully and auditing the EU's financial and economic governance arrangements is no longer uncharted territory.

Demystifying the EU's response to the financial crisis

By Tom Everett, Directorate Translation

EU speak is often cloaked in specific terminology, abbreviations and detailed references, and the language used in the financial and economic governance area often tries to showcase that instead of questioning the emperor's clothes. What efforts has the ECA made to keep its audit reports, particularly in this area, an attractive read for the 'interested but non-expert reader'? Tom Everett shares some of his hands-on experience when providing linguistic support for reports in this area.

Reaching a wider reading public



In 2015, the ECA's Financial and Economic Governance team (FEG) contacted English Language Services for drafting assistance with a series of reports on the institutional and legislative response to the 2008 financial crisis. This was a new specific area of audit in what was felt to be a complex and somewhat arcane field, and our task was twofold. As well as providing the usual advice on the way the reports were put together linguistically, we were asked to help ensure that the final product would be not only of interest to academics and experts in the field, but also understandable for a wider reading public with no special knowledge of the subject area. How could concepts like 'micro-prudential supervision', 'cascading write-down' and 'fragilities of sovereigns' be explained more clearly? And first of all, just what did these terms mean anyway?

> *How could concepts like 'micro-prudential supervision', 'cascading write-down' and 'fragilities of sovereigns' be explained more clearly?*

Uneasy lies the head …

A sovereign is 'a supreme ruler, especially a monarch'[1]. And who better to tell us about fragile sovereigns than Shakespeare? After all, from *Julius Caesar* to *Macbeth* he penned quite a few studies of the inherent difficulties of kingship. 'Uneasy lies the head that wears a crown…' is itself a principal audit finding of *Henry IV, Part 2*. So this is surely what the four EU presidents[2] meant when they spoke of 'the harmful interplay between the fragilities of sovereigns and the vulnerabilities of the banking sector'. Except that it isn't. What they were warning of, in a less literary manner, was the perils of leaving Member States to cope alone with the task of guaranteeing financial stability.

1 https://en.oxforddictionaries.com/definition/sovereign

2 Van Rompuy, Barroso, Juncker and Draghi, in the stage-setting document "Towards a genuine economic and monetary union", December 2012.

In this particular instance the four presidents could have expressed themselves more clearly. The use of "sovereign" as shorthand for 'sovereign government', in a way that might have had Shakespeare scratching his own head, is unusual outside the sphere of political science and economics. It is a term that has a specific meaning in a rather narrow context, is not immediately comprehensible for a non-specialised audience, and could therefore frighten some readers away.

Part of our job was to help the FEG team avoid just this kind of pitfall. The first report – Special Report 29/2016 - on the Single Supervisory Mechanism (SSM) refers to the above quote. Where we came in was to ensure that it was followed by a clear and concise explanation. Ideally, it would have been nice just to replace the phrase with something more accessible. But abstruse audit and financial terminology often has to be kept, warts and all, precisely because it means something very specific and very concrete. We had no remit to reinvent the wheel; the challenge was to bring the reporting style within reach of the layman reader while in no way compromising the highly technical content.

... the challenge was to bring the reporting style within reach of the layman reader while in no way compromising the highly technical content.

Keeping the reader in mind

Our reports aim to reach the 'interested but non-expert reader,' as suggested in the ECA's Performance Audit Manual. We are supposed to have this person in mind when drafting a report or other communication with the outside world. What are they like? Well, they haven't much time and, while analytical, their tastes are said to be uncomplicated: they want short and direct messages that tell it like it is.

There follows a personal take on some of the informal editing rules that have been applied, and discussed with the auditors, when assisting with the drafting of FEG reports. The general principles, of course, are just as valid for all the ECA's reporting.

- Bullet points catch the eye.
- So do tables and graphs, which are especially effective if the material is heavy on statistics. However, resist the temptation to pack a graph or chart with excessive verbiage. The authors of Special Report 10/2016 on the excessive deficit procedure chose not to describe the 'Six-pack' (legislation introduced to reform the Stability and Growth Pact) in the text, where it would have been a distraction. Instead it was summarised as part of a timeline which readers could peruse at their leisure if really interested.
- Avoid burdening the reader with unnecessary information. In Special Report 29/2016, contrary to the auditee's wishes, the functional relationship between the SSM and the European Central Bank was not described in every detail, but references in the text and footnotes directed readers interested in learning more to the relevant legislation and the ECB's website.
- Be aware which terms might need explaining in the text and/or the glossary. Auditors become experts in specific processes which are not immediately clear to a person encountering them for the first time. 'Bail-out' is clear enough, but what about 'bail-in'? Other financial terms that we felt might cause problems were those employed in a different, or narrower, sense than in the outside world: 'sovereign' or 'prudential.'

Bail-out' is clear enough, but what about 'bail-in'?

- Don't be afraid to ring the changes. The regulations draw a very precise, and legally crucial, distinction between 'financial institutions,' 'credit institutions' and the like. However, for the purposes of reporting for a wider readership it was usually sufficient to use 'banks' (which the regulations do not define). Unless use of a narrower expression is indispensable, why not scatter a few simpler terms around? It will lighten the text and reduce repetition.
- When searching for definitions, bear in mind that those given in regulations are generally drafted by lawyers and technocrats and not necessarily by native English speakers.. Definitions in an ECA report often can and should be less restrictive, and must be as free as possible of other jargon. Consider removing everything that is not strictly necessary and reformulating what is left. To be more fully informed, readers can always visit the source legislation.
- **SRB SSM SRM** FOLTF EDP BCBS ESCB EBU MREL JST NRA …The financial and economic governance area is crawling with abbreviations, some of which crop up over and over again. As a rule of thumb, where an abbreviation is little used (perhaps fewer than five times in a report), maybe it would be better avoided by writing out the term in full. "FOLTF" is a case in point: it is cumbersome and hard to pronounce, and it isn't a formal abbreviation but a shorthand form used by experts (to denote a bank that is 'failing or likely to fail'). We were tempted to ditch it in favour of something else ('vulnerable bank'?) in Special Report 23/2017 on the work of the Single Resolution Board.
- There can be a tendency to get bogged down in descriptive detail – the whys and wherefores of the financial crisis, the background to the setting-up of the SSM, the nomenclature of operational units at the ECB or (my favourite!) of government finance statistics… It is all too easy to become fixated on institutions and processes, because these are the source of the terminology and operations described. Ultimately, however, banking supervision and resolution have a simple goal: to ensure taxpayers are sheltered from the costs incurred by careless use of their money. Non-expert readers won't care whether the SSM or SRB or EIB, or the International Committee of the Red Cross, is responsible for the task: they just want to know if it's being done properly.

Once you step away from fancy terminology…

The purpose of all the above was to provide some insight into how drafting assistance was useful to the FEG auditors in taming a fiendishly complex field. Obviously an impossible task. Well … not really. It became clear that the subject is not in itself so difficult. The concepts underlying, say excessive deficits or banking resolution are actually rather simple. It is the way they are clothed that gives them an air of impenetrability. As with all audit topics, once you step away from the fancy terminology and examine the nuts and bolts, the content need not be mystifying at all.

As with all audit topics, once you step away from the fancy terminology and examine the nuts and bolts, the content need not be mystifying at all.

Helping countries to reform: ECA audits following the economic and financial crisis

By Kamila Lepkowska, Directorate Regulation of Markets and Competitive Economy

Standing in line for cash

There have been three strands to the EU's financial and economic governance over the last decade: economic governance, the Banking Union and the provision of assistance to Member States to restore their individual macroeconomic and financial health and safeguard the stability of the euro area as a whole. Kamila Lepkowska examines the audit choices made in this last strand, recounts specific experiences and homes in on certain recommendations made.

Auditing the EU's assistance to countries in difficulty

With its recent publication of a performance audit on the Commission's intervention in the Greek financial crisis (SR 17/2017), the ECA concluded a cycle of audits focusing on the EU's assistance to countries in difficulty. The three audits on this topic, all led by ECA Member Baudilio Tomé Muguruza as reporting Member, formed an important aspect of the Financial and Economic Governance Team's work. We, the auditors, had to adjust our working methods and engage more with external experts in order to audit the EU's response to the unprecedented economic and financial crisis. The findings and recommendations from the three audits complement each other and are geared towards ensuring that the EU is better prepared if required to intervene again in the future.

Sequencing the audit tasks

When the ECA's Financial and Economic Governance Team was established in autumn 2014, the preparatory work for an audit of the financial assistance to countries in difficulty (published as SR 18/2015) was already under way. The audit covered five Member States (Ireland, Portugal, Romania, Latvia and Hungary) which had received financial support from either the European Financial Stabilisation Mechanism (euro area countries) or a balance of payment programme (non-euro area countries). In this audit we decided not to cover the support provided to Greece, given the specific nature of its funding mechanism (see details in the table below) and its unprecedented size and scope.

Work on a dedicated audit on the Commission's intervention in Greece commenced soon after, with the bulk of the audit work planned for 2015. The planning period coincided with the expiration of the Second Economic Adjustment Programme for Greece and the politically difficult negotiations on the launch of the third programme. The sensitive timing required additional efforts to liaise more closely with the Commission to avoid negative repercussions on the audit task. In this context, we decided to first focus on the technical assistance delivered to Greece. The findings resulting from this part of the work were published in a dedicated report (Special Report 19/2015). In the meantime, the auditors continued their desk research on the remaining aspects of the audit, ultimately published as Special Report 17/2017.

Audit Task	Facilities examined	Main audit questions
Financial assistance provided to countries in difficulties (Special Report 18/2015)	**Balance of Payment (BoP)** **European Financial Stabilisation Mechanism (EFSM)**	Was the Commission's management of financial assistance programmes appropriate? - Were the growing fiscal risks detected on time? - Were processes sufficiently well designed to make a comprehensive input into programme decisions? - Did the Commission borrow at the best possible rates and in accordance with best debt issuance practices? - Did the financial assistance programmes meet their main objectives?
More attention to results needed to improve the delivery of technical assistance to Greece (Special Report 19/2015)	**Task Force for Greece (TFGR)** – dedicated team at the European Commission coordinating and delivering technical assistance in the context of the economic adjustment programmes	Was the EU technical assistance provided to Greece under the coordination of the Task Force for Greece managed effectively and contributed positively to the process of reforms in Greece? - Did the TFGR have appropriate arrangements for internal organisation, financing and planning of technical assistance? - Did the TFGR deliver technical assistance according to its mandate? - Did the technical assistance make a contribution to the progress of reforms in Greece?
The Commission's intervention in the Greek financial crisis (Special Report 17/2017).	**Greek Loan Facility** – First Economic Adjustment Programme for Greece **European Financial Stability Facility** – Second Economic Adjustment Programme for Greece **European Stability Mechanism** – Third Economic Adjustment Programme for Greece	Was the Commission's management of the economic adjustment programmes for Greece was appropriate? - Did the Commission have appropriate arrangements in place for managing the programmes? - Were the policy conditions appropriately designed and effectively implemented? - Did the economic adjustment programmes meet their main objectives?

Complementary audits

The above overview of the sequence of audits explains their differences in scope. The initial audit on support to countries in difficulty undoubtedly handled the broadest subject matter: not only did we cover five Member States supported under two different schemes, but we also examined a wide range of related processes. We started our analysis with the pre-programme phase, looking at the Commission's ability to identify macroeconomic imbalances in the Members States in good time. Management of the programmes was another key aspect of the audit, which also covered other processes, such as design and monitoring of the programmes' conditions, macroeconomic projections and the borrowing activities financing the programmes. Finally, we looked at whether the programmes met their objectives.

The audit task on the Greek economic adjustment programmes started with a similar approach, but significant adjustments soon proved necessary. As the precautionary procedures were equally applicable to all Member States, there was no need to review this aspect again. We also excluded borrowing activities from the scope, given that the Commission had a limited role in managing them for the financing instruments used in case of Greece. On the other hand, the single-country approach of the Greek audit allowed us to extend the audit scope as regards the design, implementation and results of policy conditionality[1]. We also carried out in-depth analyses of the reforms in five policy fields: the financial sector, taxation, public administration, the labour market and the business environment. In line with the three main objectives of the Greek programmes (fiscal, financial and growth-related), we further presented developments in the Greek economy based on a broad set of indicators.

The technical assistance audit sprang from humble beginnings as a single audit question in the plan of the audit on the intervention in the Greek financial crisis. The subject matter, however, quickly proved to be very complex, spanning a very broad thematic range of projects, and multiple institutional partners and financing mechanisms. Consequently, the supported evidence was sufficient to publish a dedicated report focusing on the organisation and planning of the technical assistance, its delivery in line with the mandate and contribution to reforms.

New working methods applied: "scorecard" on programme conditions

Given the complexity of the audits, we applied some new procedures to ensure a fair and balanced analysis. We designed a "scorecard" to help us analyse the conditions attached to the programmes; this was a detailed checklist enabling us to gain a comprehensive grasp of any problems in the design, monitoring and application of conditions. The scorecard also helped us to follow the development in conditions throughout the programmes and to evaluate the Commission's tracking of this evolution. The scorecards were tailored to each Member State and policy field, but they encouraged us to cover similar problems in each case, based on the same methodological approach. They were used not as a reporting tool but as an aid helping the auditor to structure and document their analysis, which was subsequently reported in a clearing letter to the Commission.

Use of external experts

As we dealt with highly technical and, to some extent, novel topics, we worked closely with external experts at each stage of the audit process. We held a panel discussion with a group of distinguished practitioners and scientists to scrutinise our audit approach (in the planning phase) and findings (in the reporting phase). In the field-work phase, we contracted external experts to carry out technical work, for example, on the accuracy of the macroeconomic projections and (for the Greek task) the pertinence of the reform design in specific policy fields. Furthermore, our analyses were enhanced by information obtained at numerous information-gathering meetings held with stakeholders, national authorities, experts and other international organisations.

1 Conditions to implement policy-specific reforms or legal changes.

Recommendations with impact

For a detailed understanding of the audit findings, I recommend consulting the three special reports, available on the ECA's website in all official EU languages. I focus here on the key recommendations. Despite the differences in scope and approach, together the three audits gave coherent advice to the Commission on improving its management of support programmes. Since the recommendations addressed the horizontal processes at the Commission rather than specific policy fields, they will remain relevant for future programmes. Equally, the recommendations will maintain their relevance even if the institutional framework of programme management is reviewed and certain Commission responsibilities are taken over by another entity.

Looking at the initial phases of the programme management process, all reports stressed the need for better prioritisation and clear embedment of the programmes in a broader reform strategy (of both their policy conditions and technical assistance action). This should help the countries subject to an adjustment programme to focus their reform efforts on measures most likely to effectively address the accumulated imbalances. At the other end of the programming process, all three reports recommended a more thorough evaluation of the programmes and their policies, allowing the Commission to draw lessons to improve its programme design and monitoring arrangements. Further recommendations, given in at least two of the reports, included:

- better preparedness at the Commission for rapid mobilisation of staff and expertise if a need for financial and/or technical assistance programme emerges;
- formalisation of agreements with programme partners in view of transparency and clarification of the working methods;
- better record-keeping and justification of the programmes' assumptions;
- more systematic focus on strengthening the capacity of national administrations.

New audit possibilities

Although the three presented audits constituted a coherent cycle, they did not exhaust all the possibilities for auditing programme management.

One possible audit topic could be the Structural Reform Support Service (SRSS) – an entity within the European Commission charged with providing tailor-made technical assistance to EU Member States, for example, in the context of economic adjustment programmes or, potentially in the future, euro adoption. The SRSS draws on the experience of the Task Force for Greece; an ECA audit of this entity could therefore incorporate a follow-up of the technical assistance audit.

Another option worth exploring is post programme surveillance (PPS), to which countries are typically subject after successfully completing adjustment programmes. Under the PPS, the Commission launches regular review missions to a Member State to analyse economic, fiscal and financial developments and thereby to assess its capacity to repay outstanding loans. We could conduct an audit examining the effectiveness of the Commission in managing the transition between programme and post-programme monitoring.

Both topics could be considered for inclusion in an ECA annual work programme beyond 2018. The resulting reports would complement our work on the management of the support provided to EU Member States in difficulty.

'Economic Governance': a recent priority for ECA audits

By Giuseppe Diana and Stefano Sturaro, Directorate Regulation of markets and competitive economy

Over the last decade, following the 2008 financial and economic crisis, the EU started to reform and strengthen economic governance in the Union. Giuseppe Diana and Stefano Sturaro describe this post-crisis development and present audits that the ECA has carried out or is carrying out. They also identify additional subject areas where an ECA audit may provide valuable insights.

What is 'economic governance'?

The EU's economic governance is the set of rules and processes to coordinate the Members States' economic policies at EU level. Effective governance arrangements are essential for the EU and the Economic and Monetary Union (EMU) to function well.

Within the EU and the EMU, responsibilities for economic policy are allocated among the Member States and the EU institutions. The national governments are responsible for fiscal policies – but also for labour and welfare policies – whereas the monetary policy is decided, for euro area countries, by the independent European Central Bank (ECB). Moreover, as European economies are becoming increasingly interdependent, some decisions taken by one Member State may have an impact throughout the euro area and the EU. In these cases, according to Article 121(1) of the Treaty on the Functioning of the European Union (TFEU) 'Member States shall regard their economic policies as a matter of common concern and shall coordinate them.' To do so, decisions taken by Member States must conform to rules set at EU level.

Before the 2008 crisis, the EU's economic governance focused on the sustainability of fiscal policies according to the rules of the Stability and Growth Pact (SGP). It was essentially limited to keeping public deficit and debt under control. EU governance for non-fiscal policies was limited to the Treaty provisions on soft coordination of economic policies (see Articles 121 and 148 of the TFEU). However, the economic growth in some EU Member States relied on unsustainable drivers, inducing large private and public debt, macroeconomic imbalances and divergent competitiveness. The 2008 crisis highlighted these vulnerabilities and the fact that the SGP alone was insufficient to guarantee economic stability. Consequently, over the last decade, the EU has started a process to substantially reform and strengthen economic governance.

How were economic governance arrangements reformed after 2008?

Since 2011, the EU has undertaken a range of measures to reform the Stability and Growth Pact and has extended the European Semester (originally designed to monitor the implementation of 'Europe 2020', the European Union's ten-year jobs and growth strategy) to also encompass budgetary surveillance, the implementation of the economic and employment guidelines, as well as introducing a new surveillance tool, the macroeconomic imbalance procedure (MIP).

These reforms were embedded in two legislative packages known as the 'Six Pack'[1] and the 'Two Pack.'[2] In parallel, most Member States signed the intergovernmental 'Treaty on Stability, Coordination and Governance in the EMU' (TSCG, March 2012).

More precisely, in 2011, the 'Six Pack' reformed both the preventive and the corrective arms of the Stability and Growth Pact. It was meant to introduce more flexibility in the process, giving the Commission a higher degree of discretion. However, this significantly increased the technical complexity of the SGP rules. The Six Pack also introduced the macroeconomic imbalance procedure, which has a broader focus than the Stability and Growth Pact because it considers macroeconomic imbalances in general. Consequently, the MIP is based on a wide range of analytical tools and indicators. As opposed to the SGP, which is mostly rule-based, the MIP relies essentially on economic expert judgment and discretionary elements.

EU

Meeting of the ECOFIN Council, 23 January 2018

Twenty-five of the (then) twenty-seven EU Member States (all but the United Kingdom and the Czech Republic) signed the Treaty on Stability, Coordination and Governance (TSCG), an agreement which is, according to its Article 1(1), 'intended to foster budgetary discipline (…), to strengthen the coordination of economic policies and to improve the governance of the euro area.' Title III of the TSCG, known as the Fiscal Compact, contains the provisions that are most closely linked to the SGP. In particular, it commits each country to incorporating its medium-term budgetary objective and the adjustment path towards it – as defined in the SGP – into national law. The Fiscal Compact's provisions also increase the role of independent bodies (known as Fiscal Councils), which are given the task of monitoring compliance with the national budgetary rules.

Some of these provisions were incorporated into the 'Two Pack' which entered into force in 2013. It aims to enhance coordination and surveillance in two ways. First, it requires euro area Member States to base Draft Budgetary Plans for the following year on independent macroeconomic forecasts and to present them in mid-October. This ensures that fiscal policy is based on realistic figures, is discussed early in the budgetary process and that the Commission's guidance can be taken into account before national budgets are adopted. Moreover, it requires the setting up of Fiscal Councils, tasked with monitoring compliance with national budgetary rules. Second, the Two Pack requires Member States, under the excessive deficit procedure, to regularly submit detailed reports presenting their progress on complying with the EU's fiscal recommendations.

1 Regulations (EU) No 1173/2011, No 1174/2011, No 1175/2011, No 1176/2011, No 1177/2011 and Directive 2011/85/EU.

2 Regulations (EU) No 472/2013 and No 473/2013.

Road map for deepening Economic and Monetary Union

In June 2015, the "Five Presidents Report"[3] laid down a roadmap to deepen Economic and Monetary Union in two stages. During the first stage, lasting until June 2017 ('deepening by doing'), the EU institutions and euro area Member States built on the existing legal framework to boost competitiveness and structural convergence and to foster sound fiscal policies at national and euro area level.

In the second stage ('completing EMU') to be completed by 2025, the convergence process would be made more binding through a set of agreed benchmarks for convergence that could be enshrined in EU legislation. Meeting these standards - or making significant progress towards them - would be among the conditions for each euro area Member State to participate in a shock absorption mechanism.

Following up the five Presidents' report, the Commission has taken steps to strengthen and streamline the European Semester. Moreover, to help Member States to design and carry out structural reforms, upon request the Commission provides tailor-made technical support to all Member States through the Structural Reform Support Programme (SRSP) coordinated by its Structural Reform Support Service (Regulation (EU) 2017/825). The SRSP's budget is currently €142.8 million for the period 2017-2020.

In addition, new independent actors are being involved. In the near future national Productivity Boards will provide independent analyses of productivity and competitiveness developments and resulting challenges in the Member States. In parallel, at EU level, the European Fiscal Board, an independent advisory body, was set up to advise the Commission on fiscal matters. Similarly, setting up a European productivity board is being considered.

Furthermore, in March 2017 the Commission presented a White Paper[4] assessing progress made in Stage 1 and outlining the next steps needed, including amendments to the legal framework, to complete EMU in Stage 2. This was followed by a set of five reflection papers, including one on the deepening of the EMU[5]. Finally, on 6 December 2017, the European Commission presented a package of initiatives[6] 'to increase the unity, efficiency and democratic accountability of the EMU.'

In particular, it includes proposals to:

- bring the European Stability Mechanism (ESM) into the EU legal framework, turning it into the European Monetary Fund.
- double the budget of the Structural Reform Support Programme.
- integrate the substance of the Treaty on Stability, Coordination and Governance into EU law.

3 'Completing Europe's Economic and Monetary Union', Report by Jean Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, 22 June 2015.

4 White paper on the future of Europe (March 2017): https://ec.europa.eu/commission/white-paper-future-europe-reflections-and-scenarios-eu27_en

5 Reflection paper on the Deepening of the EMU (May 2017): https://ec.europa.eu/commission/publications/reflection-paper-deepening-economic-and-monetary-union_en

6 The 6th December Package: https://ec.europa.eu/commission/publications/completing-europes-economic-and-monetary-union-factsheets_en

- add a new euro area budget line within the EU budget, to fund structural reforms, provide a stabilisation function, act as a backstop for the Banking Union, and as a convergence instrument to provide pre-accession assistance to candidate euro area Member States.
- establish a European Minister of Economy and Finance.

The five Presidents report also focused on the social dimension of Europe. The ensuing debate led to the approval by the Council in November 2017 of the European Pillar of Social Rights. This Charter aims at supporting fair and well-functioning labour markets and welfare systems. It is primarily conceived for the euro area, but it can be adopted by all interested EU Member States.

ECA audits on economic governance: past, ongoing and future.

The EU’s economic governance is a recent priority area for ECA audits. The continuously evolving legal framework and implementation environment make auditing this area particularly challenging but also very stimulating.

Completed audits:

The ECA published Special Report 10/2016 on the Excessive Deficit Procedure in 2016 and Special Report 3/2018 on the Macroeconomic Imbalance Procedure in 2018. In these audits we have found that, in spite of the Commission’s efforts over the years to strengthen and improve both procedures, they are still not fully effective. The main weaknesses identified concern the complexity of the rules, the lack of transparency in the decision-making process and the Commission’s reluctance to make full use of the enforcement tools available.

Ongoing and planned audits:

The ECA has started two audits on the European Semester, one on the preventive arm of the SGP and the other on overall coordination of economic policies and structural reforms. Moreover, an audit is considered on fiscal stability in the EU, focusing on the implementation of the requirements for budgetary frameworks in the Member States (Council Directive 2011/85/EU of 8 November 2011).

Potential topics for future audits:

Potential future audit topics include:

- Effectiveness of the SRSS and the SRSP in helping EU countries to design and implement structural reforms to support job creation and sustainable growth;
- Impact of the new tools devised by the Commission to foster national ownership for the implementation of structural reforms;
- Landscape review on EU Economic Governance, building on the audits performed in this area;
- Pertinence of the Commission’s economic analysis leading to entry into the Euro area.

Furthermore, depending on the implementation of the ’6th December package,’ other potential audit topics could be: effectiveness of the European Monetary Fund; effectiveness of the broader economic policy coordination resulting from the integration of the TSCG into the EU law; functioning of the European Ministry of Economy and Finance; the management of the euro area budget line for the stabilisation function, backstop for the banking union, and convergence instrument for pre-accession to the euro. However, besides depending on progress in realizing the deepening of the European economic governance arrangements, future ECA audits will also depend on potential risks in policy delivery and suggestions received from our stakeholders. With its current pace of development, this area will continue to be a very challenging area to audit.

The ECA's efforts to strengthen the Banking Union and EU's financial supervisory authorities

By Helmut Kern, Directorate of Regulation of Markets and Competitive Economy

The plethora of institutions and authorities set up to monitor and supervise the Banking Union and financial sector has added many new abbreviations and acronyms to the EU's lexicon which surface increasingly in the media: ESA, SSM, SRB, to name but a few. Helmut Kern guides us through the maze of jargon and sheds light on what the ECA has done to audit some of these bodies.

EU / Daniel Roland

Breaking a vicious circle

Almost ten years ago, an economic tsunami broke out with the failure of Lehman Brothers and its shock waves swept across the Atlantic Ocean to the European continent. The shock left banks, governments and even whole countries drowning or on the brink. It was the most serious and disruptive financial crisis since 1929 and imposed unprecedented costs on the EU economy. Between October 2008 and October 2014, the Commission took more than 450 decisions authorising state aid measures to the financial sector amounting to approximately € 5 800 billion. The bulk of these measures took the form of state guarantees for liabilities in order to ensure the funding of banks. The figures show that the crisis was a crisis of confidence. The slogan "too big to fail" became a threat, with banks so big and so important that Member States could not allow them to fail. As soon as Member States provided state aid, their creditworthiness came under pressure. As a result, interest rates rose on the back of credit rating agencies' downgrading. This led to more failures among borrowers, which again negatively affected bank assets. The vicious cycle started to circle and EU governments came under heavy pressure to break the loop.

One of the causes of the global financial crisis was inappropriate credit ratings: borrowers' credit ratings had been inflated. Trusting these credit ratings, banks and other lenders acquired securities, e.g. collateralised debt obligations, which afterwards led to losses. As a result, public attention turned to the role of credit rating agencies and the impact of their ratings on the financial markets.

The 2009 report by the High-Level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, stressed the need to overhaul credit agency supervision, to strengthen and centralise bank supervision, and to establish an effective resolution regime. The Group also called for a coherent and workable regulatory framework for crisis management, and harmonised and pre-funded deposit guarantee systems.

In a first step, the EU laid the foundations with the adoption of three regulations for the establishment of the European Supervisory Authorities (ESAs) to supervise and provide regulatory guidance. All established in 2011, the three ESAs are the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

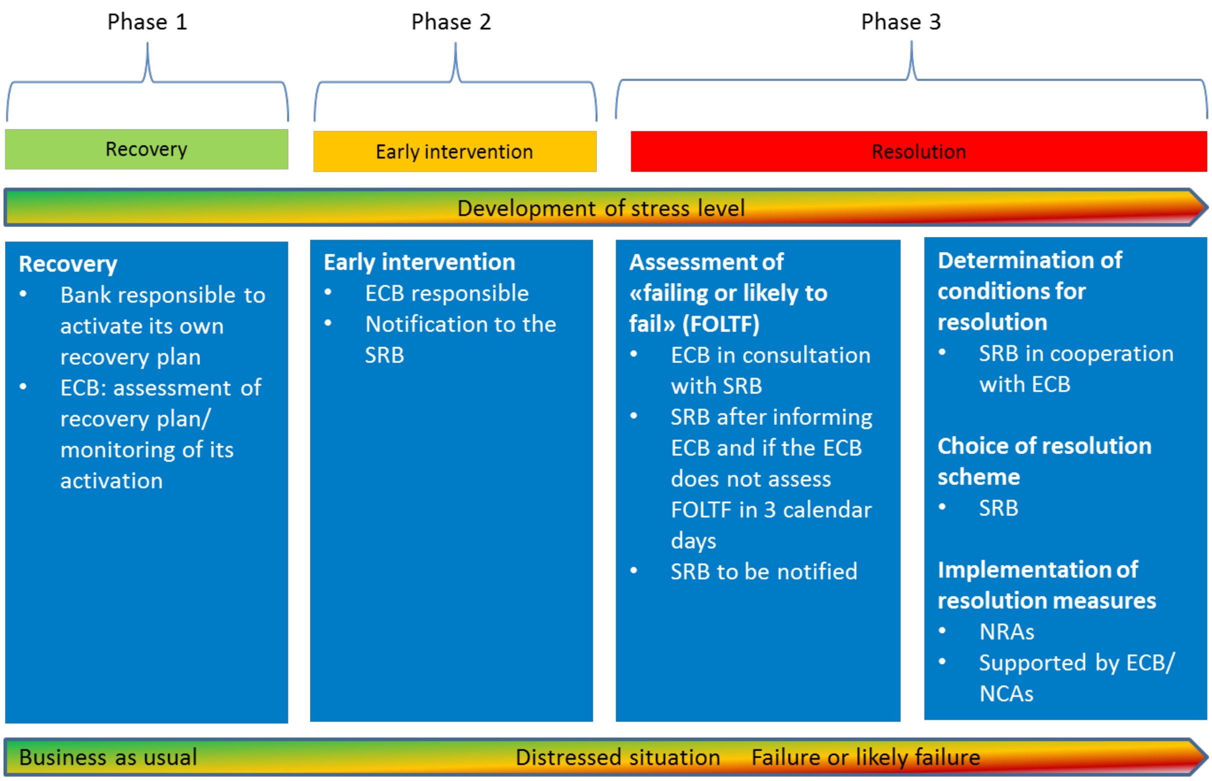
The main task of the EBA is to contribute to the creation of the European Single Rulebook, which will produce a level playing field in the area of banking. The EBA also coordinates stress testing on banks located in the EU. ESMA was given exclusive supervisory powers over credit rating agencies registered in the EU. It is now responsible for registering credit rating agencies, monitoring their performance and taking supervisory decisions. The EIOPA's main task is to ensure high, effective and consistent regulation and supervision of insurance companies and pension funds, especially for cross-border groups.

In a second step, the supervision of around 130 of the most significant banks (see page 34 and 35), which account for 80 % of the total banking assets in the euro area, was transferred to the European Central Bank (ECB) in November 2014. The supervision of 3 500 less significant banks remained the responsibility of the national competent authorities (NCAs). Joint Supervisory Teams, which comprise staff from both NCAs and the ECB, conduct day-to-day supervision, also called 'off-site supervision'. In addition, the ECB carries out on-site inspections, i.e. in-depth investigations of risks, risk controls and governance, with a pre-defined scope, at the bank's premises. This cooperation and sharing of tasks in the field of bank supervision is also known as the Single Supervisory Mechanism (SSM).

Taking its third step, the EU legislator decided to establish the Single Resolution Board, which is responsible for resolving significant banks supervised directly by the ECB and cross-border banks. Resolution can be described as the orderly unwinding of a failing bank, without the use of taxpayers' money, preventing significant adverse effects on financial stability. Beginning work in 2015, the SRB became fully operational at the start of 2016. The SRB owns the Single Resolution Fund (SRF), which collects contributions from all banks and may be used to ensure the efficient application of resolution tools and the exercise of the resolution powers conferred to the SRB. Currently holding €17 billion, by the end of a transitional period terminating in 2024, the SRF should have collected a total of €55 billion. This amount appears low compared with the amount of state aid that has already been approved for banks. It should be borne in mind that the SRF can only be used if shareholders, bondholders and depositors have born losses equivalent to 8 % of total liabilities. These creditors will be subject to a write-down and bail-in of their equity, bonds or deposits.

Participation in the SSM and the SRB is mandatory for euro area countries, yet other Member States may also join the Banking Union. Indeed, Sweden and Denmark are currently reviewing whether to do so and the results of their studies are expected in autumn 2019.

The table below presents the task-sharing between supervisors and resolution authorities.



Source: ECA, adapted from the ECB

Recovery plans are prepared by the banks, and then assessed and monitored by the supervisors. They lay down measures to be taken by the bank to restore its financial position following a significant deterioration. If the financial condition of a bank degenerates further, the next, more serious phase is the early intervention phase, where the supervisor is entitled to impose measures, for example, forcing the bank to change its business strategy.

The resolution authorities' task is to prepare in good times for the bad times. This entails establishing a plan for the orderly winding-up of a bank at a time when it is not in difficulty.

As stated in the Five Presidents' Report[1] on completing Europe's Economic and Monetary Union, the work is not finished. The pillars of the Banking Union for supervision and resolution have been built, but the pillar on deposit guarantee systems remains national. The Commission has proposed introducing a European Deposit Insurance Scheme at the SRB. The audits I have done have convinced me of the importance of functioning deposit guarantee schemes.

Finally, yet crucially, the roadmap for deepening Europe's Economic and Monetary Union proposes transforming the European Stability Mechanism (ESM) into a European Monetary Fund (EMF), constituted as an EU body. One of the tasks of the EMF would be to serve as a financial backstop for the resolution of banks. Only if the financial means of the SRF had been exhausted would the EMF provide financial support, which the banks would subsequently need to pay back.

1 'Completing Europe's Economic and Monetary Union,' Report by Jean Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, 22 June 2015.

SMM directly supervised banks

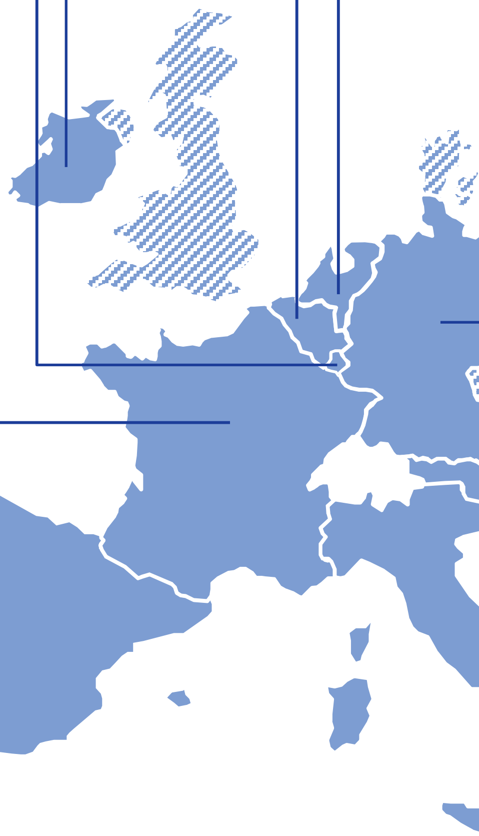
Belgium
Investeringsmaatschappij Argenta N.V.
AXA Bank Belgium S.A.
Banque Degroof Petercam S.A.
Belfius Banque S.A.
Dexia N.V.
KBC Group N.V.
The Bank of New York Mellon S.A.

The Netherlands
ABN AMRO Group N.V.
Bank Nederlandse Gemeenten N.V.
Coöperatieve Rabobank U.A.
ING Groep N.V.
Nederlandse Waterschapsbank N.V.
de Volksholding B.V.

Ireland
Allied Irish Banks, public limited company
Citibank Holdings Ireland Limited
Permanent tsb Group Holdings plc
Bank of Ireland Group plc
Ulster Bank Ireland Designated Activity Company

Luxembourg
Banque et Caisse d'Epargne de l'Etat, Luxembourg
J.P. Morgan Bank Luxembourg S.A.
Precision Capital S.A.
RBC Investor Services Bank S.A.

France
Barclays Bank plc
BNP Paribas S.A.
BPCE S.A.
Bpifrance S.A. (Banque Publique d'Investissement)
Confédération Nationale du Crédit Mutuel
C.R.H. – Caisse de Refinancement de l'Habitat
Crédit Agricole S.A.
HSBC France
La Banque Postale
RCI Banque S.A.
SFIL S.A.
Société générale S.A.



Portugal
Banco Comercial Português S.A.
Caixa Geral de Depósitos S.A.
Novo Banco S.A.

Spain
ABANCA Holding Financiero S.A.
Banco Bilbao Vizcaya Argentaria S.A.
Banco de Sabadell S.A.
BFA Tenedora De Acciones S.A.U.
Banco Mare Nostrum S.A.
Banco Santander S.A.
Bankinter S.A.
Ibercaja Banco S.A.
CaixaBank S.A.
Banco de Crédito Social Cooperativo S.A.
Kutxabank S.A.
Liberbank S.A.
Unicaja Banco S.A.

Italy
Banca Carige S.p.A. – Cassa di Risparmio di Genova e Imperia
BANCA MONTE DEI PASCHI DI SIENA S.p.A.
Banco BPM S.p.A.
BPER Banca S.p.A.
Banca Popolare di Sondrio, Società Cooperativa per Azioni
Barclays Bank plc
Credito Emiliano Holding S.p.A.
ICCREA Banca S.p.A. – Istituto Centrale del Credito Cooperativo
Intesa Sanpaolo S.p.A.
Mediobanca – Banca di Credito Finanziario S.p.A.
UniCredit S.p.A.
Unione di Banche Italiane Società per Azioni

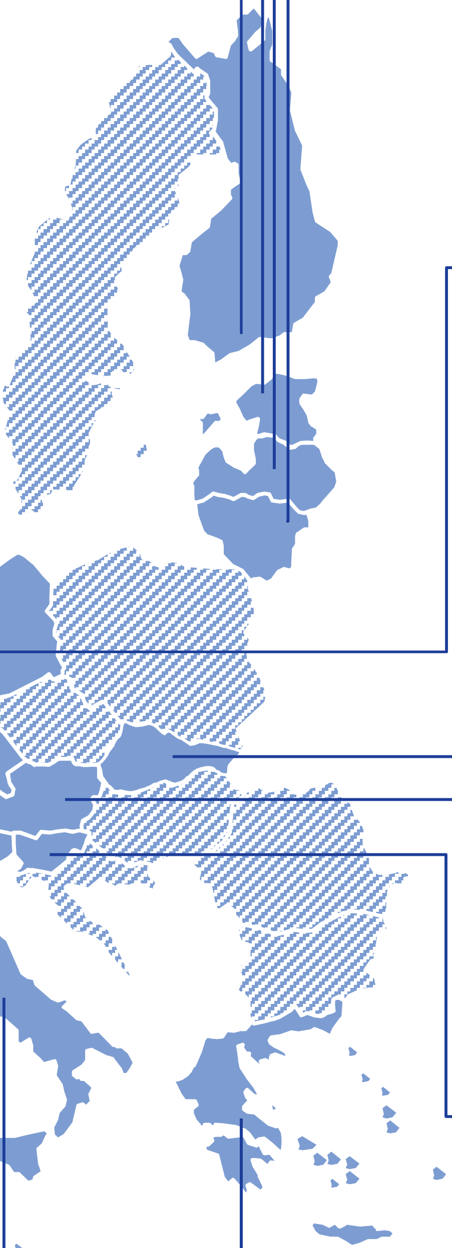
Source: European Central Bank and ECA

Finland
Danske Bank Plc
Kuntarahoitus Oyj
Nordea Bank AB (publ), Suomen sivuliike
OP Osuuskunta

Estonia
AS SEB Pank
Swedbank AS

Latvia
ABLV Bank AS
AS SEB banka
Swedbank AS

Lithuania
AB DNB bankas
AB SEB bankas
Swedbank AB



Germany
Aareal Bank AG
Barclays Bank PLC Frankfurt Branch (§)
Bayerische Landesbank
COMMERZBANK Aktiengesellschaft
DekaBank Deutsche Girozentrale
Deutsche Apotheker- und Ärztebank eG
Deutsche Bank AG
DZ BANK AG Deutsche Zentral- Genossenschaftsbank
Erwerbsgesellschaft der S-Finanzgruppe mbH & Co. KG
HASPA Finanzholding
HSH Beteiligungs Management GmbH
Deutsche Pfandbriefbank AG
Landesbank Baden-Württemberg
Landesbank Hessen-Thüringen Girozentrale
Landeskreditbank Baden-Württemberg- Förderbank
Landwirtschaftliche Rentenbank
Münchener Hypothekenbank eG
Norddeutsche Landesbank - Girozentrale
NRW.BANK
State Street Europe Holdings Germany S.à.r.l. & Co. KG
Volkswagen Bank Gesellschaft mit beschränkter Haftung

Slovakia
Slovenská sporiteľňa a.s. (‡)
Tatra banka a.s. (‡)
Všeobecná úverová banka a.s. (‡)

Austria
Promontoria Sacher Holding N.V.
Erste Group Bank AG
Volksbank Wien AG
Raiffeisenbankengruppe OÖ Verbund eGen
Raiffeisen Bank International AG
Sberbank Europe AG
VTB Bank (Austria) AG

Slovenia
Abanka d.d.
Nova Ljubljanska Banka d.d. Ljubljana
Biser Topco S.à.r.l.

Greece
Alpha Bank S.A.
Eurobank Ergasias S.A.
National Bank of Greece S.A.
Piraeus Bank S.A.

Cyprus
Bank of Cyprus Holdings Public Limited Company
Cyprus Cooperative Bank Ltd
Hellenic Bank Public Company Limited
RCB Bank Ltd

Malta
Bank of Valletta plc
HSBC Bank Malta p.l.c.
MeDirect Group Limited

Entries marked with (§) refer to supervised entities which were newly identified as significant in the latest annual assessment of significance; the direct supervision of these entities starts on 1 January 2018.

Entries marked with (‡) refer to supervised entities which are subsidiaries of a significant institution in another Member State and are also among the three largest credit institutions in the home Member State.

The ECA's audit of the EBA and ESMA

In our audit of the EBA (Special Report 5/2014), we assessed whether the Authority had satisfactorily put in place the new arrangements for the regulation and supervision system. We found that the EBA had responded to the financial crisis with a broad regulatory agenda. The EBA had contributed to improving the cross-border supervision of banks. However, its role in banking supervision was limited in many areas, like the assessment of the resilience of EU banks and the promotion of consumer protection.

In Special Report 22/2015 we examined whether ESMA's registration and supervision of credit rating agencies were effective. Credit rating agencies issue opinions that help reduce the asymmetry of information among borrowers, lenders and other market participants. They are an important tool in the equity and bond markets as they contain information for investors and market participants, in some cases even replacing investors' due diligence. Banks also use them in risk management.

Our overall conclusion was that ESMA had managed, in just a short period of time, to lay solid foundations for supervising the EU's credit rating agencies. However, there was room for improvement. The regulatory framework was unclear and complicated the process. Therefore, ESMA faced challenges in interpreting the rules and forging a common understanding with the credit rating agencies. Eurosystem rules did not place all ESMA-registered credit rating agencies on an equal footing. The Eurosystem only accepted ratings issued by four ESMA-registered agencies which were external credit assessment institutions under the Eurosystem credit assessment framework. ESMA's rules and guidelines were incomplete and documentation and internal monitoring tools somewhat rudimentary. The scope of ESMA's supervisory activities was not yet comprehensive.

The ECA's audit of the SSM and the SRM

Three ECA audits relate directly to the Banking Union. All three came up against an important obstacle, namely a disagreement with the ECB over the exact terms of the ECA's mandate and right to access documents. Arguing that we were overstepping our remit, the ECB was not willing to share certain documents, data and information. This also emerged in the SRB audit, where the SRB redacted data and information originating from the ECB.

In our first audit of the SSM (Special Report 29/2016), we focused on its establishment. In particular, we looked at the new mechanism's governance structure (including the work of internal audit), arrangements for accountability (including external audit), and the organisation and resourcing of off-site and on-site supervision.

Our main findings were that that the SSM had been set up on time but that, owing to the involvement of national supervisory authorities, the supervisory structure was rather complex and relied on a high degree of coordination and communication between ECB staff and the NCAs. The ECB was bound by legislation to observe a clear separation between its monetary policy and supervisory functions. However, within the ECB, the SSM Supervisory Board exercised no control over the supervisory budget or human resources. This raised concerns about the independence of the two areas of the ECB's work, as did the fact that some ECB departments provided services to both functions without clear rules and reporting lines that would minimise possible conflicting objectives. We also sounded the alarm on resourcing and staffing in almost all areas. The ECB was found to be heavily dependent on staff appointed by national authorities for off-site supervision and exercised insufficient control over the composition and skillset of teams. On-site supervision was also the ECB's responsibility, but here we identified the problem that inspection teams typically included very few ECB staff.

In our second SSM audit (Special Report 2/2018), we examined the ECB's crisis management. Crisis management involves advance recovery planning and the supervisor identifying a deterioration in a bank's financial situation. The ECB should, where necessary, exercise its early intervention powers.

We found that the ECB had established a substantial framework for crisis management procedures and that the ECB's organisational set-up and resourcing for the assessment of recovery plans and the supervision of banks in crisis were satisfactory. The ECB's operational crisis management framework had some flaws, and there were signs of inefficient implementation. We observed that guidance for early intervention assessments was underdeveloped and did not define objective criteria or indicators for determining whether a bank had entered a crisis. We obtained no comprehensive evidence on the ECB's actual use of its powers, so we could not conclude on the efficiency of its management in practice. Guidance on "failing or likely to fail" assessments was also lacking in scope and detail.

The scope of the SRB audit (Special Report 23/2017) was resolution planning for individual banks. We also examined whether the SRB's own system of manuals and procedures for resolution-planning and the cooperation framework were adequate.

We identified shortcomings in the SRB's preparation of resolution plans. The SRB had not yet completed resolution planning for the banks within its remit and the plans adopted did not meet a substantial number of requirements laid down in the Single Rulebook. Delays in staffing had impaired all areas of the SRB's activities.

ECA contributing at the initial phase and beyond

The financial crisis of 2008 led to distrust in the financial markets. The establishment of dedicated authorities for the euro area was an important step to regain this trust and preserve financial stability. Distrust first mounted in relation to credit ratings, which are an elementary component of the financial market. Another important point is that any non-viable banks must exit the market. However, this exit should not spark financial instability. In June 2017 the ECB identified three banks in the euro area as failing. These three banks were wound up in an orderly manner. The experience showed that financial stability is vulnerable and that supervisory and resolution authorities are needed to do their job.

Disagreements regarding the interpretation of the ECA's audit mandate meant that the audits on the SSM and SRM were somewhat limited in scope. Still, the

ECA was able to draw important conclusions. Nevertheless, this issue needs to be settled for future audits.

All the ECA’s audits in this area were first-time audits dealing with newly established bodies. Through its special reports the ECA had an opportunity to assess and help improve the work of these authorities at a very early stage. The reports revealed shortcomings in a number of areas. Follow-up audits will help to ensure that the recommendation made are implemented as agreed.

Further new audits will be undertaken, for example the audit of the EIOPA, which the ECA has set as a high priority audit task. Here the ECA will assess whether the EIOPA ensures supervisory convergence and contributes to financial stability in the insurance and pension markets. With the Banking Union developing further, other interesting audit topics will undoubtedly turn up on the horizon. One could be an in-depth examination of EBA’s stress testing. Furthermore we should keep in mind that the legislator obliged the ECA to carry out a performance audit on the SRF once it is used.

The current proposal of the roadmap for deepening Europe's Economic and Monetary Union does not foresee an ECA audit mandate for the EMF. Yet our audits have shown that the EU bodies involvedion to date are far from perfect. Auditing these bodies boosts accountability and provides added value, both for the bodies themselves and the European citizen. Consequently, it would be make sense for the ECA to have a mandate to audit the EMF.

Supervisory practices and audit gaps: the Contact Committee Task Force on Banking Union

Peter van Roozendaal, Algemene Rekenkamer (Netherlands Court of Audit)

Peter van Roozendaal giving a presentation at a meeting of the Contact Committee Task Force on Banking Union

The new banking supervision arrangements introduced in 2014 have not only led to many changes at EU level but also at Member State level. They created a new audit landscape both for national audit institutions and for the ECA. Peter van Roozendaal, team leader at the Netherlands Court of Audit for its audit on banking supervision (published in September 2017), provides insights into what is done at public audit level to coordinate, share audit experiences and identify audit gaps.

Mandate for a parallel audit by the Contact Committee

In 2015, following the introduction of the Single Supervisory Mechanism (SSM) in November 2014, the Contact Committee of Supreme Audit Institutions of the EU adopted a statement on banking supervision and the importance of fully auditable, accountable and effective banking supervision arrangements.[1] The reason for the statement was that the introduction of the SSM brought about new challenges regarding transparency, accountability and adequate public audit. For example, a number of national SAIs which previously had the mandate to audit the supervision of the largest – so-called 'significant' – banks, lost this mandate when responsibility for supervision was transferred from national supervisors to the ECB. Most worrying for these SAIs at that moment was that when the ECA was preparing its first audits of the ECB's supervisory activities, it became clear that the ECB's position was that the ECA's mandate for auditing the operational efficiency of the ECB's management would not include how supervision is carried out in practice. The SAIs concluded that the loss of their previous audit mandates over banking supervision could not be compensated by the ECA's mandate at ECB level, and that an 'audit gap' had emerged which needed to be closed as soon as possible.

1 Contact Committee statement: Ensuring fully auditable, accountable and effective banking supervision arrangements following the introduction of the Single Supervisory Mechanism. http://www.eca.europa.eu/sites/cc/Lists/CCDocuments/CC_STATEMENT_2015/CC_SSM_statement_EN.pdf

With the statement, the Contact Committee also set up the 'Task Force on Banking Union'. The Task Force was mandated to conduct a *parallel audit* of the supervision of medium-sized and small banks in selected EU countries. The SAIs of Austria, Cyprus, Finland, Germany and the Netherlands actively carried out audits, and another 11 SAIs provided background (public) information about banking supervision in their countries.[2] The ECA also participated in the Task Force, and provided useful assistance as a sounding board for the SAIs involved.

Why the Netherlands Court of Audit decided to participate

This topic was not new for the Netherlands Court of Audit. It had been paying close attention to developments at EU level leading up to the introduction of the Capital Requirements Directive IV in 2012. In fact, as a consequence of the implementation of this Directive in the Dutch Financial Supervision Law, the Netherlands Court of Audit in May 2014 finally received the full mandate for audit supervision of all banks in the Netherlands. Then about 6 months later when the SSM was established, the Netherlands was one of the countries where the SAI lost an important part of that mandate, i.e. regarding the audit of the supervision of 'significant' banks.

The board of the Netherlands Court of Audit decided that now it had a new mandate, this also had to be exercised. Even if it meant that an audit would be limited to the supervision of medium-sized and small banks. The board considered this task to be of great importance, and volunteered to co-chair the activities of the Task Force, together with the German SAI, the *Bundesrechnungshof*.

Objectives, approach and scope of the parallel audit

The objectives of the parallel audit were twofold. First, to gain insight into possible differences among EU Member States in the regulatory framework for banking supervision after the introduction of the SSM, and the way the respective national supervisors had set up and carried out prudential supervision. Secondly, to collect evidence about possible 'audit gaps' that have emerged since the introduction of the SSM. The scope of the audit was limited to prudential supervision of medium-sized and small banks.

To meet the objectives, the participating SAIs carried out their audit work following a common audit plan, and summed up their findings in a country report.[3] At the end, a joint report was drafted based on the individual country reports, each of which had undergone contradictory procedures as is customary in the countries concerned. Each of the SAIs involved in the parallel audit carried out audit work in accordance with their own national practices. In Austria and the Netherlands, the audit work not only focused on the prudential supervisor, but also involved the role of their respective ministries of Finance.

In order to carry out in-depth observations of supervision in practice, the SAIs of Austria, Cyprus, Germany and the Netherlands requested and received access to the supervisory files of selected banks. The SAIs obtained access to sensitive and/or confidential supervisory data. They applied the same disclosure requirements on confidentiality and professional secrecy standards as the supervisory authorities, and took measures to safeguard the information against unauthorised access and disclosure. This also applied to the Task Force as a whole. The final report aggregates and compares national results, but sensitive and/or confidential information is not disclosed.

2 SAIs of Bulgaria, Croatia, Estonia, Greece, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania, Slovenia, Sweden and the United Kingdom.

3 The SAIs of Cyprus, Germany and the Netherlands carried out the full audit plan. The SAIs of Austria and Finland focused mainly on the design of supervision in their audits.

Main results: different supervisory practices and increasing audit gaps

The report of the Task Force was adopted by the Contact Committee and published on 14 December 2017.[4] The main results of the parallel audit are twofold. First, there are differences in regulatory transposition, design and practice of banking supervision in EU member states. Second, the suspected 'audit gaps' have been confirmed and are increasing.

Regarding the first conclusion, the parallel audit identified differences in how EU rules are transposed into national laws. We found that within one common supervisory system different national rules and regulations apply, which is of course allowed. We also found that there are differences in the institutional design of prudential supervision. Most often the national central bank is responsible for prudential supervision but in some countries the prudential supervisor is set up as a separate institution or responsibilities are shared between the Central Bank and a national competent authority, such as in Austria and Germany.

We also found a number of differences in supervision practice in the participating countries:

- Different methods, either designed by the ECB or using national approaches, for categorizing banks according to their systemic relevance and for assessing risks.
- The proportionality of the annual assessment in the Supervisory Review and Evaluation Process (SREP) – in which the business model, governance and risk management, capital and liquidity position of banks are assessed – varies between countries.
- In some countries the substantive focus in the SREP is on assessing risks to capital, liquidity and sustainability of funding, while in other countries the focus is on assessing banks' business models and the adequacy of their governance and risk management.
- Some national authorities mainly use quantitative interventions (such as imposing capital add-ons), while others primarily use qualitative interventions (such as requesting the removal of business deficiencies).

Our second conclusion pertains to the 'audit gaps'. We had already seen in the ECA's report on the SSM of November 2016 that the loss of mandate by some national SAIs after the introduction of the SSM was indeed not compensated by a clear and undisputed mandate for the ECA.[5] Additionally, our parallel audit showed that SAIs with a full mandate to audit the supervision of medium-sized and small banks are facing increasing difficulties in accessing relevant information. This is the case because more and more documents regarding the supervision of medium-sized and small banks are subject to ECB rules and standards. In addition, in a very similar way to the difficulties facing the ECA, ECB information crucial to audits on the supervision of medium-sized and small banks is not shared with SAIs. This new 'audit gap' will increase in importance

4 Report of the Task Force on European Banking Union to the Contact Committee of Supreme Audit Institutions of the European Union and the European Court of Auditors on prudential supervision of medium-sized and small ("less significant") institutions in the European Union after the introduction of the Single Supervisory Mechanism. https://www.eca.europa.eu/sites/cc/Lists/CCDocuments/Task_Force_EBU/Task_Force_EBU.pdf

5 At the time of finalizing the Task Force report, the second SSM audit of the ECA was not published yet.

in the coming years as the ECB issues more guidance and methodology to harmonize the prudential supervision of medium-sized and small banks.

The European Commission's first review of the SSM states that the ECA's mandate 'is indeed more limited than the mandates of certain national Supreme Audit Institutions over national banking supervisory authorities.'[6] The Commission encourages the ECA and the ECB to conclude an inter-institutional agreement that specifies the arrangements for information exchange in order to grant the ECA access to all the information it needs to perform its audits. This could be a first step towards improving the external accountability of the supervisory tasks of the ECB. Ultimately, however, the Task Force is of the opinion that the ECA's audit mandate may need to be clearly defined by means of an amendment to secondary law (SSM Regulation) and possibly primary law to generate greater legal certainty and create a sustainable solution.

Presenting the results of the Task Force in the Netherlands

The Netherlands Court of Audit's report about banking supervision in the Netherlands was published on 27 September 2017. It was presented by us in the Dutch House of Representatives, and generated a fair amount of media attention, especially regarding the role of the Dutch Minister of Finance in supervising the supervisor. On 28 November 2017 the report was also presented in a meeting of the CEOs of banks in the Netherlands.

On 14 December 2017 the Task Force's report was published. The Netherlands Court of Audit sent a letter to parliament – making it an official publication of the Netherlands Court of Audit – in which the results of the Task Force are summarized. On the same day, articles written by the President of the *Bundesrechnungshof,* Kai Scheller, and the President of the Netherlands Court of Audit, Arno Visser, focusing on the 'audit gaps,' were simultaneously published in the German *Handelsblatt* and the Dutch *Financieel Dagblad*.

Finally, on 30 January 2018, both the report about banking supervision in the Netherlands and the report of the Task Force were presented by us in the Dutch Senate. The 'audit gaps' in particular, and how to close them, were the topics of lively discussion in the Senate.

Next steps

The Task Force will now shift its attention to the second pillar of the banking union, the European resolution mechanism. In its meeting in October 2017 in Luxembourg, the Contact Committee mandated the Task Force to follow up on audit gaps in banking supervision, and 'to prepare a mapping survey of arrangements in Member States concerning banking resolution, in view of relevant audit work to be carried out in the future.'

A starting point for the future activities of the Task Force is provided by the ECA's first report on the Single Resolution Board, published in December 2017. In March 2018 the Task Force will meet in Luxembourg for a training session on the European Resolution Mechanism, given by ECA staff. The Task Force intends to finalize an overview of the results of the mapping survey around the summer of 2018, and present a report with a proposal for a potential new parallel audit to the Contact Committee in October 2018.

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6 Report from the Commission to the European Parliament and the Council on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013. COM(2017) 591 final, 11 October 2017.

IMF expert providing support to ECA audits: 'A fruitful cooperation for mutual learning!'

Ruben Lamdany

Interview with Ruben Lamdany, Deputy Director of the Independent Evaluation Office (IEO) of the IMF

By Gaston Moonen, Directorate of the Presidency

Being relatively new in auditing financial economic governance issues inviting external experts to participate in a panel of experts became even more important. Ruben Lamdany of the IMF shares his impressions as external expert for two ECA reports in this area.

Getting involved at an early stage

The ECA frequently involves external experts in its audit work. They are asked to comment on audit scope and approach or on the draft report once the audit has been finalised. Ruben Lamdany, Deputy Director of the Independent Evaluation Office (IEO) of the International Monetary Fund (IMF), who has over 10 years of experience with the IEO, and prior to that as senior manager in the evaluation office of the World Bank, acted as expert in two of the ECA reports in the financial economic governance area. When first contacted to share his experiences with the ECA his reply was similar to when he was invited in 2014 as external expert: 'I will gladly do so, with pleasure!'

The IMF played a substantial role in economic rescue operations in the EU after the crisis in 2008, providing funds through so-called Extended Fund Facility and Stand-By Arrangements. Currently the IMF has at least 10 programmes in European countries, mostly in EU Member States. As to the role of the IEO, Ruben explains: 'As IEO we prepared two reports, one on the 'IMF Response to Financial and Economic Crisis' in 2014, and the second on 'The IMF and Crises in Greece, Ireland and Portugal' in 2016, which went more or less parallel with the first two ECA reports in this area, covering the same, but often more, countries.'

When asked about how he became a member of the expert panel, he recalls: 'I was called out of the blue, with no previous contact with the ECA. However, for quite some time now I have been evaluating these kind of programmes, so that must have been the reason. It was nice to see that some of the panel members the ECA had invited were the same ones we at the IEO used for external expertise. This speaks highly of the ECA because they were able to select well-known people in this field, despite having less experience than the IEO.'

Mutual benefits

The cooperation has been fruitful in both ways: 'When the first ECA report relating to countries in difficulties was published in 2015, the IEO first report had just been issued, so it was mostly helpful to us in validating the findings of our own report. The ECA's 2015 report regarding the task force for Greece was also very useful in providing information and helping us understand the European perspective. From the descriptions and background information provided there we learned quite a bit about processes in the EU.' Ruben found the ECA auditors to be very knowledgeable when it comes to how mechanisms work inside the Union: 'We are supposed to look at the whole picture, not only at Europe, so the ECA staff has a wider and deeper knowledge about the EU and its processes than we do.'

Ruben remarks that the ECA's work and IEO evaluations complement each other, but that there are also differences: 'The two ECA reports I was involved in had several compliance aspects in them. It has of course economic analyses, etc. but the focus is on processes: are things well organised to ensure a good outcome. And this is logical since in the follow-up, for example by the European Commission, this can be relatively addressed easily.' He continues that the IEO also looks at process but even more so at outcomes. He gives an example:

Interview with Ruben Lamdany, Deputy Director of the Independent Evaluation Office (IEO) of the IMF *continued*

'One can have a lengthy discussion with the auditee – be it with IMF staff or Commission staff - on how forecasts and projections are done. Here the IEO will focus more on whether they turned out to be correct, while the ECA might focus more on whether they did a good job in organising their forecasting task.' He adds: 'In some ways the ECA audits might have a more immediate impact than our evaluations because the ECA is more directly integrated into the EU architecture and governance. In our case the IEO evaluates what the IMF does and provides recommendations. However, it is up to the Executive Board representing the member countries to decide whether to adopt these recommendations. Moreover, the IEO is not involved in their implementation, and only indirectly in their monitoring.

As to the methodology used by both organisations, Ruben believes there are several similarities: 'If you look at the full array of working papers you have in ECA audits and at those the IEO has, you will see many similarities in approaches and methodology. If you only look at the main reports you will find perhaps less similarities because we choose to emphasize different things.' Interestingly, the IEO, unlike the ECA, publishes all its working documents.

Continuity as challenge

As for the future Ruben sees continuity as ECA's major challenge. He explains: 'Let me first say that the ECA did a fabulous job with its reports, particularly considering that it was the first time the ECA was doing this. And every time you do this type of audit you most likely will get better. So there is a learning curve, and related to that is a learning cost.' Ruben makes clear that he hopes for the EU that there will not be many more assistance packages in the future. 'However, if you do not have this and only have one every decade, then the ECA will have to re-learn everything from scratch each decade. At the IMF we are evaluating lending programmes day in, day out. The ECA is only doing it to the extent it happens and till 2008 it had never happened. So this will be a major challenge: to preserve the expertise while it may be only a one-off exercise.'

When speaking about the mechanisms to prevent a future crisis Ruben is rather prudent: 'I can mainly say that there is a long learning curve for many governments and regions on how to set up an effective mechanism and govern it. It takes a lot of time and a lot of political will. Usually people are more willing to build them in the middle of a crisis but in the middle of a crisis they are busy with other things.' Ruben concludes that often when the crisis subsides one is less busy with crisis management but less interested in the topic too.

Overall, Ruben looks back to a fruitful cooperation: 'I hope that my contribution was helpful. On our side we were pleased with the presentation ECA Member Baudilio Tomé gave here at the IEO. This was an ad hoc event and hopefully it remains the last of its kind.' He adds with a laugh: 'If there are no more programmes to evaluate there is no need for cooperation.' Then more seriously: 'Even if I am not here anymore at the IEO I can assure you that the IEO will always be ready to provide support to both the ECA and EU Member States in providing advice on evaluations and more generally in supporting evaluation capacity. After all, one should not forget that European countries are among the largest shareholders of the IMF!'

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The European Parliament's support unit on Economic Governance – and how they use ECA reports

Interview with Marcel Magnus, European Parliament's Economic Governance Support Unit

By Gaston Moonen, Directorate of the Presidency

Marcel Magnus

Helping the European Parliament to make well informed choices

Producing audit reports is one thing, using them in the public scrutiny process is something else. Marcel Magnus from the European Parliament explains how his unit uses the ECA reports on financial and economic governance issues to provide input to the Committee on Economic and Monetary Affairs (ECON).

The Economic Governance Support Unit (EGOV) is part of the European Parliament's Directorate for Economic and Scientific Policies. The team comprises economists and statisticians and follows closely what is happening in the Banking Union and in the Euro area. Marcel Magnus is one of them, with about 5 years of experience in the European Parliament while working now 10 years on banking related topics. He explains what he does: 'While my colleagues focus on topics like the European Semester, country-specific recommendations, financial assistance programmes etc., I specifically monitor the developments in the European banking industry.' He indicates that when the two European bodies – the Single Supervisory Mechanism (SSM) within the ECB and the Single Resolution Board (SRB) - were set up and put directly in charge of the largest banks, their new responsibilities were imbedded in a strong accountability framework. 'To ensure the transparency and legitimacy of their work, both institutions not only have to submit annual reports, but they also have to take part in public hearings in the ECON committee several times per year. Both Danièle Nouy of the SSM Supervisory Board and Elke König of the SRB appear several times per year in the EP's ECON Committee'.

Both Danièle Nouy of the SSM Supervisory Board and Elke König of the SRB appear several times per year in the EP's ECON Committee'.

When speaking about EGOV output Marcel indicates: 'Our main role is to provide input to the ECON Committee, so our unit provides it with background information, including for those public accountability hearings. We assist ECON Members in their scrutiny activities with regard to economic governance and the Banking Union. Moreover, we publish most of our briefings on the EP's websites and from the feedback received we know that our briefings have a wider readership inside and outside of the house.'

To broaden the knowledge base, we also work closely with external experts ...

Marcel points to the factual papers his unit produces, for example, on banks' exposures to home sovereign bonds, overcapacities in the European banking sector, the evolution of the Basel framework, the orderly liquidation of Veneto Banca and Banca Popolare di Vicenza, and the resolution of Banco Popular. He adds: 'To broaden the knowledge base, we also work closely with external experts, who are highly respected academics and specialists in their field of expertise, so that we can cover additional topics of interest in more detail, based on a mandate of the competent committee. Most recently, we have published on the request of the ECON Committee external briefings on provisioning policies for non-performing loans and on the relevance of critical functions in cases of bank resolution, for example. The papers by external experts also take a normative approach and may include policy recommendations.'

ECA reports as important source for the public scrutiny process

While EGOV looks at information coming directly from banks it also bases its products on other well-informed sources. Marcel underlines that ECA reports, for example the recent special reports on the SSM and the SRB, are important information sources for him and his colleagues. 'The ECA reports are very relevant for our work. Of course we have seen that there is some disagreement in particular between the ECB and the ECA as to the scope of the audit mandate. This may have affected the access to underlying documentation and the extent as to which the ECA was able to draw overall conclusions. Still, all these reports benefited from a rather exclusive access to information that is not available to others, and we are therefore keen to read what the auditors' take on the SRB's and ECB's operational efficiency and effectiveness is.'

When discussing how the ECA reports are used for his own work Marcel explains: 'We take the ECA's reports to cross-check whether the main findings are in line with our own perception of the underlying issues, and some of the ECA findings might lead us to have a second look. Of course, we do not have the same access to information as the ECA, our analysis hence takes a different approach, based on the monitoring of publically available information. Members of the competent Committee may also request to have follow-up analyses by external experts.'

Marcel believes that one of the objectives of audit reports could be to state if developments go in the right direction: 'The ECA reports assess what has been achieved within a given timeframe, and they also give a judgement whether more could be achieved or what not.' He also underlines that ECA reports do not shy away from addressing critical issues. He refers to an example in the SRB report: 'One point may be particularly relevant as regards the practical feasibility of bail-in procedures, as it says: "*Bailing in deposits and bonds in the space of 48 hours would be an immense technical challenge for most banks given the complexity of their management and IT systems*." With that statement, the ECA really addresses a thorny issue, since swift and smooth resolution procedures is what everybody is looking for in case of need.'

> *With that statement, the ECA really addresses a thorny issue, since swift and smooth resolution procedures is what everybody is looking for in case of need.*

ECA reports benefit from unique access to first hand information

When asked what distinguishes ECA reports from other material he may use in his work Marcel reflects: 'A strong point of the ECA reports is certainly the rather unique access to first-hand information, which is ideally assessed by knowledgeable and impartial people. Legislators may also be specifically interested in findings that are directly related to the substance of the legislative framework. As an example, the ECA's SRB report mentions that the legislative framework creates challenges for the SRB as regards differences in the scope of the SRB and ECB, the flow of information between these two institutions, and concerning the activation of a moratorium tool. I think ECA input on whether a legal framework as such might need to be modified to make it work in practice can be very useful. He then concludes: 'As we in EGOV have to do our analysis based on publically available information, any work that contributes to increased transparency is more than welcome!'

Report on EU interventions in the Greek financial crisis serving public scrutiny at national level

Interview with Joost Sneller, Member of the Dutch parliament

By Gaston Moonen, Directorate of the Presidency

Joost Sneller

ECA reports mostly focus on actions undertaken at EU level, but the financial ramifications of these actions are often visible enough at national level and discussed by national parliaments. This seems to be particularly true for the EU interventions in the Greek financial crisis. In December 2017, the Finance Committee of the Dutch parliament, with ECA Member Alex Brenninkmeijer acting as *trait d'union*, invited ECA Member Baudilio Tomé to present our work on this programme at a parliamentary hearing. I asked Dutch parliamentarian Joost Sneller about the meeting in particular and ECA reports in general.

Media headlines following ECA's special report on assistance to Greece

'When the ECA issued its report on the Commission's intervention in the Greek financial crisis in November 2017 it got quite a few headlines in the Dutch media, and rather critical ones.' Joost Sneller, Member of the Dutch parliament, is rather outspoken why his Finance Committee invited Baudilio Tomé, the reporting Member for this report, to present the audit to the Dutch parliament. 'At the moment our committee is deeply involved in the debate about the reform of the Economic and Monetary Union. In the Netherlands there is strong interest in what happened with the financial assistance given to Greece some years ago. This report and the media headlines following its publication suggest that the Commission did not have its things in order. And this may have contributed to the difficulties in implementing the support packages and the approach towards the needed structural reforms in Greece.' He adds that this conclusion might not do justice to the subtleties of the conclusions and recommendations. And that this report is an important opportunity for learning, particularly in view of the current discussions whether to transform the European Stability Mechanism (ESM) into a European Monetary Fund (EMF).

Joost Sneller explains that reports like these from the *Algemene Rekenkamer*, the Netherlands Court of Audit, are typically discussed in the Finance Committee of the Dutch parliament. Moreover, the Committee has a coordinating role when dealing with audit reports. He also thinks that his Committee will be interested in other ECA reports in the financial and economic governance topics: 'These ECA reports look like they are in the bull's-eye of the interest of the Finance Committee.' During that meeting eight MPs asked questions and, while time is limited, the views expressed can be very diverse. 'You have about an hour to discuss something that is very wide ranging, with the entire political spectrum present, ranging from people who think 'we should not have helped Greece at all' to the ones who say 'we have not helped Greece enough'. And then other people who feel that the situation represents a failure of European values.'

As to the discussions for establishing a European Monetary Fund (EMF) Joost Sneller has some specific views: 'I think it could be more useful to talk about the substance of the assistance programmes rather than the label.' He underlines that the role the Commission played in Greece was a first time experience and that there has been a steep learning curve for the Commission. 'If there were to be another programme in another country, many things would be done differently, due to the situation on the ground. This, I believe, includes the cooperation with the ECB.' Joost Sneller makes the analogy with the International Monetary Fund (IMF): 'The IMF has on-going programmes in many countries where they make in depth analyses, including for preventive purposes. If there would be a European version of the IMF it would be important for it to do this as well.' He also believes that having a substantial monitoring function embedded in a future EMF will have a positive impact during programme implementation: ' It would make things a lot easier if we would have a rapid response facility before things go wrong'.

Public scrutiny to raise the attention

Joost Sneller finds it is rather difficult to get to the bottom of a report like the ECA one on the EU interventions in the Greek financial crisis within the scope of an hour. 'For me as MP there is always this question: what is most effective and productive? Spending time reading a report – and that time is unfortunately limited - or attending a parliamentary hearing.' For Joost Sneller organising a hearing also helps to raise public attention, create more awareness, and show that you find this particular topic important. He continues: 'Holding a hearing at the Dutch parliament also signals to our government - and to the European Commission - that as legislative branch we follow this topic with interest, and that therefore the executive branch should also step up their game.'

Following the meeting with Baudilio Tomé the Finance Committee had a meeting with the European Commission on the same topic, but with a particular focus on the implementation of the third programme. Joost Sneller remarks: 'One of the first things said by the representatives of the European Commission was that they took on board all the ECA recommendations, thereby immediately trying to kill any controversy.' He finds it very important to hear what the executive branch has done with a report's recommendations. 'Of course you would need a follow-up report from the ECA to see whether these recommendations have also been implemented.'

Same programme, different audit mandates

In his preparations for the parliamentary hearing on this report Joost Sneller realised that, given the mandate of the ECA the report did not

> *These ECA reports look like they are in the bull's-eye of the interest of the Finance Committee.*

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analyse the role of the European Central Bank (ECB) or the IMF in great detail. There was also limited information on the way the three actors in the programme interacted. 'The ECB played a very particular role, but if you only analyse operational efficiency you will never find out what happened. And the IMF has its own internal audit and evaluation structures. Therefore my question: is the audit mandate of the ECA wide enough to examine these support programmes, and their effectiveness, in their entirety? This is something we should look into.'

As to the follow up given to this report by his Finance Committee, Joost Sneller indicates that there will soon be a plenary debate on this topic in the Dutch parliament. 'All parties will take from the meeting with the ECA and the Commission what they consider relevant to the plenary debate. The questions relating to the ECB, and their interpretation of the ECA's audit mandate, will be taken up with the ECB itself.' On that part he explains that meetings have been foreseen with the ECB, also during a working visit to Frankfurt to discuss some of the findings. He connects this issue also to something else: 'There is also the report[1] brought out by national audit institutions who argue that the ECA should be given a stronger audit mandate regarding ECB activities. For the *Algemene Rekenkamer* this mandate discussion is rather relevant.'

ECA recommendations relevant for national MPs

Joost Sneller hopes the ECA will focus more and more on performance auditing. 'Of course this can be hard when there is no counterfactual analysis, or limited possibilities for benchmarking. But in the end this is what you want to arrive at, to say something about impacts and outcomes.' He has a concern in this respect: 'Who else is going to evaluate whether we should have helped the Greeks in this way and how we can help another country better next time. This was perhaps not the main aim of this ECA report, but it is of course the essential question.'

He also reflects that it would be very useful if ECA reports would be more discussed by national parliaments. 'Of course, the interest of national parliaments will differ depending on the topic addressed in a report. But we cannot leave this to the European Parliament alone, while respecting each other's role of course.' He believes that ECA reports clearly contain recommendations where it would be well advised for national parliamentarians to take action. He concludes: 'And to take into account when discussing with the national representatives in the Eurogroup or in preparation of an ECOFIN meeting with your own minister of Finance. Or any European Council meeting for that matter.'

> *... it would be very useful if ECA reports would be more discussed by national parliaments. [...] we cannot leave this to the European Parliament alone ...*

1 Report of the Task Force on European Banking Union to the Contact Committee of Supreme Audit Institutions of the European Union and the European Court of Auditors on prudential supervision of medium-sized and small ("less significant") institutions in the European Union after the introduction of the Single Supervisory Mechanism. https://www.eca.europa.eu/sites/cc/Lists/CCDocuments/Task_Force_EBU/Task_Force_EBU.pdf

Developing a compelling growth strategy for the EU

By Adrian Savin and Jacques Sciberras, Directorate Regulation of markets and competitive economy

Is there a need for a growth strategy at EU level and what should its purpose be? What are the critical factors for developing such a strategy and what would the necessary building blocks be for its successful implementation across the Union? Adrian Savin and Jacques Sciberras are both involved in the ECA's ongoing performance audit on the European Semester and the Commission's role in coordinating the fiscal and economic policy of Member States. In this article they share their views on these important questions regarding the economic governance of the EU.

Is there a need for a growth strategy at EU level?

Article 5 of the Treaty on the Functioning of the European Union (TFEU) proposes that Member States should coordinate their economic, employment, and even social, policies within the Union. Furthermore, the Council is charged with responsibility for formulating Broad Economic Policy Guidelines (BEPGs) under Article 121(2) of the TFEU and employment guidelines under Article 148 of the TFEU. These so-called 'Integrated Guidelines' constitute the basis for the formulation of policy strategies at the Union level. So far, such policy strategies have been developed twice: the 'Lisbon Strategy' of 2000-2010 and the 'Europe 2020 strategy' for 2010-2020.

Success or failure of public policies in these key areas has a direct impact on the quality of millions of people's lives, both in today's and tomorrow's generations. Developing a coordinated strategy geared towards economic growth, job creation, cohesion, and social inclusion is an arduous task. This is particularly so in the case of a Union of 28 Member States, with views on key economic, social and political matters that are not always aligned. However, several levers are expected to help agreeing on a common strategy at EU level: a single market, a single currency, and gradual convergence of financial, banking and fiscal surveillance.

An EU-wide growth strategy is not only a long list of structural reforms. It also has to address numerous dimensions in a consistent manner:

- identifying priorities, risks and opportunities;

- proposing a reasonable and consistent policy mix to address them;

- developing a sequence of reforms with reasonable deadlines and a monitoring system;

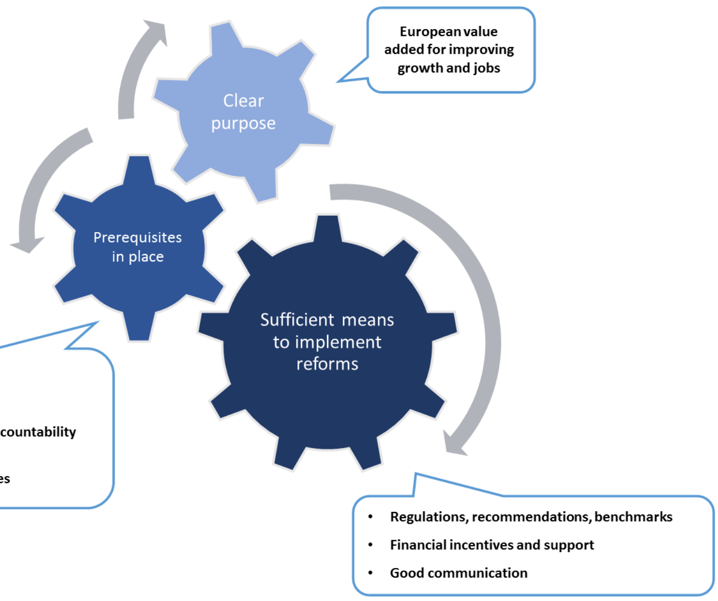
- making political choices which reflect social, cultural, and consumer preferences; and

- it also needs to take into account constantly changing technological advances which impact both production and consumption patterns and the unequal capacities of Member States and regions to compete in a global market.

Prerequisites for a compelling growth strategy at Union level

Getting the right policy mix is a complex process, which involves budget allocations, taxes, exchange rates, trade and industrial policies, regulations, privatizations, and the impact of monetary policy, to name just a few. Coordination of these policies is all the more important at the EU level.

Developing a compelling growth strategy for the EU *continued*



Source ECA

As complex as these are, we think that beyond the political, social or economic considerations outlined above, the form of the strategy and the means to implement it are as important as its purpose.

The EU has been more successful in certain policy dimensions than in others by agreeing on common goals and putting them into action. When it comes to a common growth strategy, there are important implementation risks. Understandably each Member State wants to differentiate its strategy so that it is fit for purpose in the national context. Each Member State wants to exploit its perceived competitive advantages, and common ground may be less important than developing their respective unique selling propositions. In so doing, the process of shaping a common strategy at Union level leads to a sprawling set of objectives which must be generic enough to suit the aspirational needs of its diverse Member States.

Firstly, could more focused messages be developed to explain what the EU's growth strategy is about? For example a better pitch:

- to investors, on why the EU - whichever Member State they invest in - is a better place to invest in than any other part of the world;
- to researchers, on why the EU is the best place to undertake research and eventually take it to market;
- to industry, on why the EU is the most productive and competitive market to position oneself in;
- to citizens, on why having a common strategy will benefit everyone in a fair manner.

A compelling strategy therefore needs to plant a 'motivation gene' which enables each stakeholder to answer the question 'why this is important for me?'

Secondly, more clarity about the roles and responsibilities of different actors for implementing the strategy would be helpful. The current setup leads the EU to present ambitious goals, which depend entirely on Member States to be implemented. Shaping a clearer 'governance and accountability framework' and giving much clearer signals of who is responsible for what, is a key success factor in implementing the strategy.

The third prerequisite is the ability to ensure fairness and ownership during implementation. It is easy to define common standards or common supervision for banks, financial markets or fiscal policies, but it is more difficult to sustain such processes if deviations are not controlled. Managing free riding, opportunistic regulatory arbitrage or deliberate behaviour counter to the strategy (which ignores or opposes the common objectives), may lead to short-term gains for certain Member States but may also lead to long term costly spillovers for others. To be effective, a Union-wide strategy needs a credible and impartial authority, which can mediate and enforce fair implementation between the parties involved.

The capacity and means to implement an EU-wide strategy effectively

The Commission clearly has the authority and legitimacy to develop such a strategy. But this is not sufficient. The capacity and means are equally important. An agenda for structural reforms across Europe requires substantial fiscal and institutional resources. The current setup is based on the subsidiarity principle of distributed responsibility for implementation by national and regional authorities. They are the ones with the necessary fiscal resources and operational capacity to implement reforms. At the EU level therefore, the means to coordinate and implement a common strategy are limited and essentially boil down to either the force of law – i.e. through regulation, monitoring and enforcement - or to persuasion and 'soft law' mechanisms.

Finally, there is also another aspect. There must be transparent and objective communication about the advantages and disadvantages of putting in place a Union-wide growth strategy, and what the alternatives would look like, to persuade Member States and their citizens that this is the best way forward. Goodwill by Member States is a prerequisite for success, but is not sufficient in this respect. Making a clear and persuasive case in a multi-tier democratic society and developing effective 'levers for implementation' are equally important.

Fiscal sustainability during a recession: economic feasibility and political will

By Giuseppe Diana and Stefano Sturaro, Directorate Regulation of markets and competitive economy

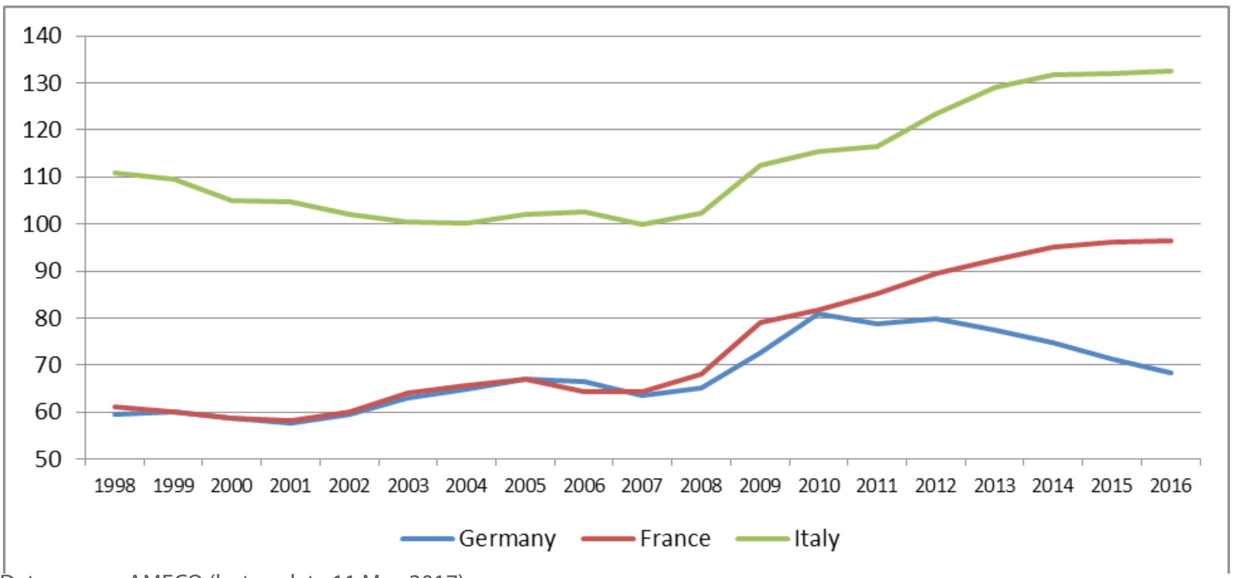
The financial economic governance area often involves extensive financial-economic analysis to get a deeper understanding of why things happened as they did. And what the outlook for the future could be. Giuseppe Diana and Stefano Sturaro provide such analysis below, looking into the debt-to-Gross Domestic Product ratio dynamics in Germany, France and Italy from the creation of the EMU in 1999 until 2016 and investigating the drivers behind. They argue that, in order to maintain fiscal sustainability during a severe crisis, two conditions have to be met simultaneously and explain why only Germany was able to fulfil both conditions. Buckle up for some economic formulas and number crunching!

Introduction

Below we analyse, from the creation of the EMU in 1999 until 2016, the debt-to- Gross Domestic Product (GDP) ratio dynamics in Germany, France and Italy, the three largest economies in the euro area[1].

Figure 1 shows that, from 1998 to 2008, the trend in the debt ratio was slightly positive in both France and Germany and moderately negative in Italy. With the 2008 crisis the debt dynamic at once became markedly positive in all three countries. In France and Italy the debt ratio has continued to rise ever since, though the rate of increase has been slowing. In Germany, after a peak in 2010, the debt-to-GDP ratio started to fall and is now approaching pre-crisis levels.

Figure 1: Debt-to-GDP ratio in Germany, France and Italy, 1998-2016



Data source: AMECO (last update 11 May 2017)

1 Germany, France and Italy accounted for around 2/3 of euro-area GDP and public debt in 2015 (AMECO, last update 11 May 2017).

In other words, while Germany managed to overcome the impact of the 2008 crisis on its debt-to-GDP ratio, France and Italy did not since, in 2016, their debt-to-GDP ratios were 30 percentage points higher than before the crisis. As a consequence, both France and Italy are now more vulnerable to adverse shocks than they were in 2008. Their fiscal position should also raise concerns for the euro area as a whole should a new severe economic and financial crisis hit.

Breakdown of the debt-to-GDP dynamics

The drivers behind public debt dynamics are the primary balance, the snowball effect and the stock-flow adjustment. These terms are defined in the box below. Our objective is to disentangle the reasons underlying the debt dynamics in Germany, France and Italy. More specifically, we aim to tease out the factor of political will (or the lack thereof), using the primary balance as a proxy, from the two other drivers, neither of which is (directly) under government control.

Box 1: Drivers behind public debt dynamics - primary balance, the snowball effect and the stock-flow adjustment

The primary balance is the budget balance net of interest payments on general government debt[2].. It indicates the (positive or negative) amount of new debt created by the government and can be considered an indicator of fiscal discipline. The snowball effect is the effect on public debt accumulation arising from the differential between the nominal interest paid on public debt and the nominal GDP growth rate. Where b is the debt-to-GDP ratio, if the average nominal interest rate i on the stock of debt is higher than the nominal rate of GDP growth δ, the snowball effect $(i - \delta)b$ will mechanically create upward pressure on the debt-to-GDP ratio. The stock-flow adjustment groups all changes in public debt that cannot be explained by the fiscal balance. It includes changes (accumulation and sales) in government assets, changes in the value of debt denominated in foreign currency and sundry statistical adjustments. Even if they can have a significant impact in the short term, one would normally expect stock-flow adjustments to cancel out over a longer period[3]. As a consequence, to stabilise the debt-to-GDP ratio, it is usually enough to achieve a primary balance that offsets the snowball effect.

To summarise, the evolution of the debt-to-GDP ratio can be broken down by the respective impact of these three drivers as:

$$\Delta b = d + SBE + SFA$$

where Δb is the change in the debt-to-GDP ratio, d is the ratio of primary deficit[4] to GDP, $SBE = (i - \delta)b$ is the snowball effect and SFA is the stock-flow adjustment.

2 Government debt means the total gross debt at nominal value outstanding at the end of the year for the general government sector.

3 For a detailed presentation of the stock-flow adjustment and its components, see for example Eurostat (2017) "Stock-flow adjustment (SFA) for the Member States, the euro area and the EU28 for the period 2013-2016, as reported in the April 2017 EDP notification".

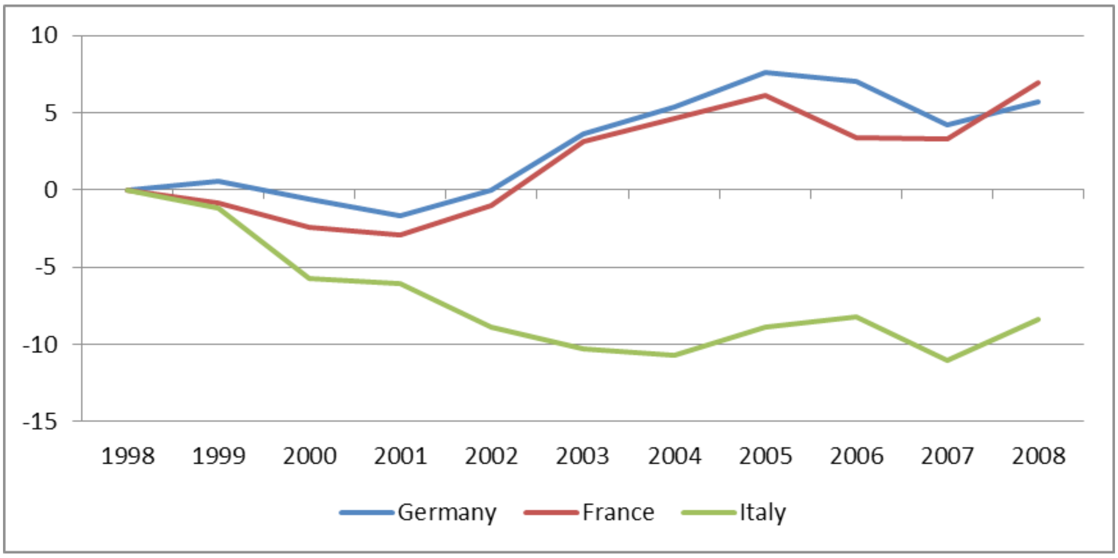
4 A primary surplus would contribute to decreasing the public debt. In that case, as a primary surplus is equivalent to a negative deficit, d would be negative.

In the next two sections, we use the equation in the box above to breakdown the debt-to-GDP variation in the three countries under scrutiny before and after the onset of the 2008 financial crisis.

Before the crisis

Before the 2008 crisis, the evolution of the German and French debt-to-GDP ratios followed the same pattern. As shown in ***Figure 2***, the cumulative increase in the ratio from 1998 to 2008 was very similar in Germany and France (up by 5.7 and 7.0 percentage points respectively). In Italy, meanwhile, the ratio fell by 8.4 percentage points.

Figure 2: Cumulative debt-to-GDP variation (% of GDP) in Germany, France and Italy, 1998-2008

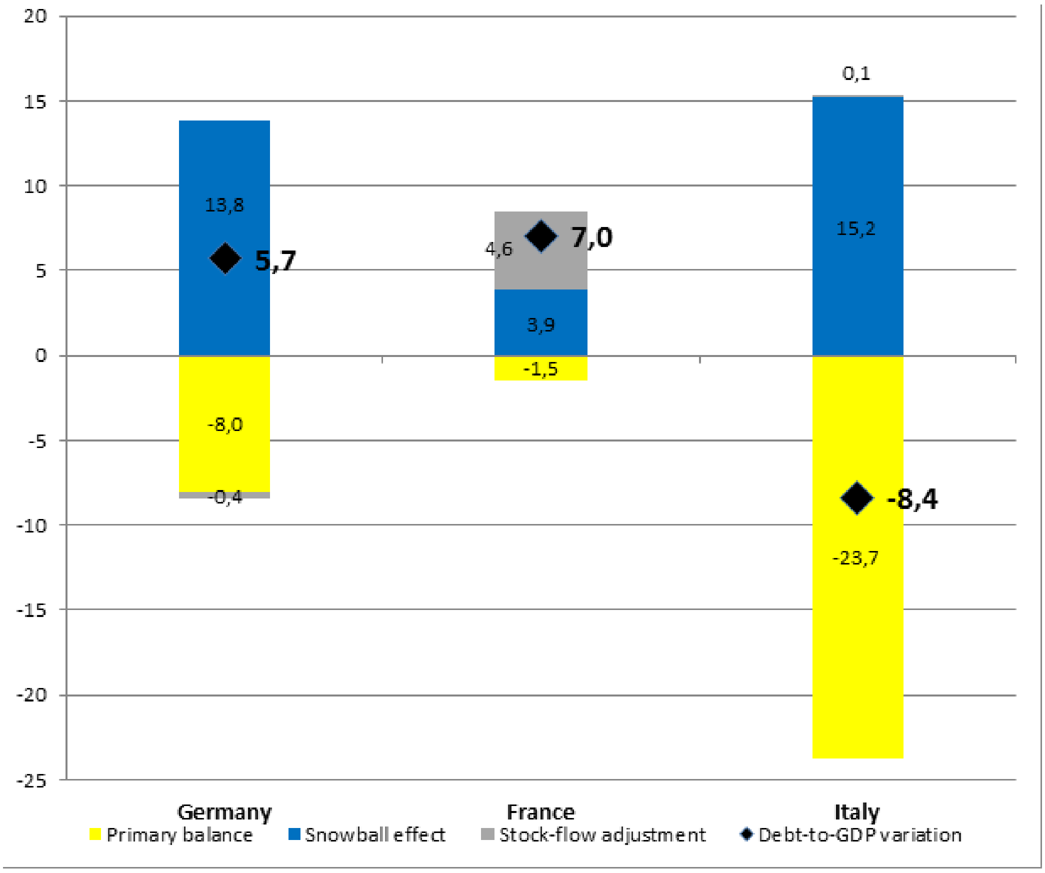


Data source: AMECO (last update 11 May 2017)

In the ten years to 2008, France, Italy and, to a lesser extent, Germany all experienced favourable economic conditions, with annual nominal growth rates averaging 3.9 %, 3.7 % and 2.4 % respectively and output gaps averaging 1.8 %, 1.2 % and 0.1 %[5].

5 The output gap is the difference between actual output and the estimated potential output which is consistent with no inflationary pressure. It gives an indication regarding the cyclical position of the economy. A positive output gap indicates an outperforming economy.

Figure 3: Breakdown of the debt-to-GDP variation (% of GDP), 1998-2008



Source: Authors, based on AMECO data (last update 11 May 2017)

Benefitting from these benign cyclical conditions, Italy made efforts to implement fiscal consolidation[6]. However, this only resulted in a moderate decrease in the Italian debt-to-GDP ratio. Indeed, as shown by ***Figure 3***, over the decade before the 2008 crisis Italy only managed to reduce its debt by 8.4 % of GDP (from 110.8 % to 102.4 % of GDP). The reason is that, while managing during that period to accumulate a significant primary surplus of 23.7 % of GDP, Italy had a high stock of debt. As a consequence it had to cope with a substantial snowball effect of 15.2 % of GDP, which offset around two thirds of its fiscal effort.

Although the debt-to-GDP dynamic during the decade ending 2008 was very similar in Germany and France, the underlying reasons were quite different. Germany made fiscal efforts to maintain the sustainability of its public debt, as indicated by its cumulative primary surplus of 8.0 % of GDP, although this was still insufficient to compensate for a sizeable snowball effect (13.8 % of GDP) linked to weak nominal growth, due in part to low wage and price growth in Germany in the early years of EMU, in an effort to regain competitiveness. France had a very small cumulative primary surplus of 1.5 % of GDP, but because of stronger nominal growth it derived the benefits of a very limited snowball effect (3.9 %). The main reason why the French debt-to-GDP ratio increased over the period was a stock-flow adjustment of 4.6 % of GDP.

6 However, some authors (for example Cottarelli, C. (2016) Il macigno – perché il debito pubblico italiano ci schiaccia e come si fa a liberarsene Serie bianca, ed. Feltrinelli, p. 24) suggest that, given the low interest rates available to Italy through membership of the euro area, it could and should have done more.

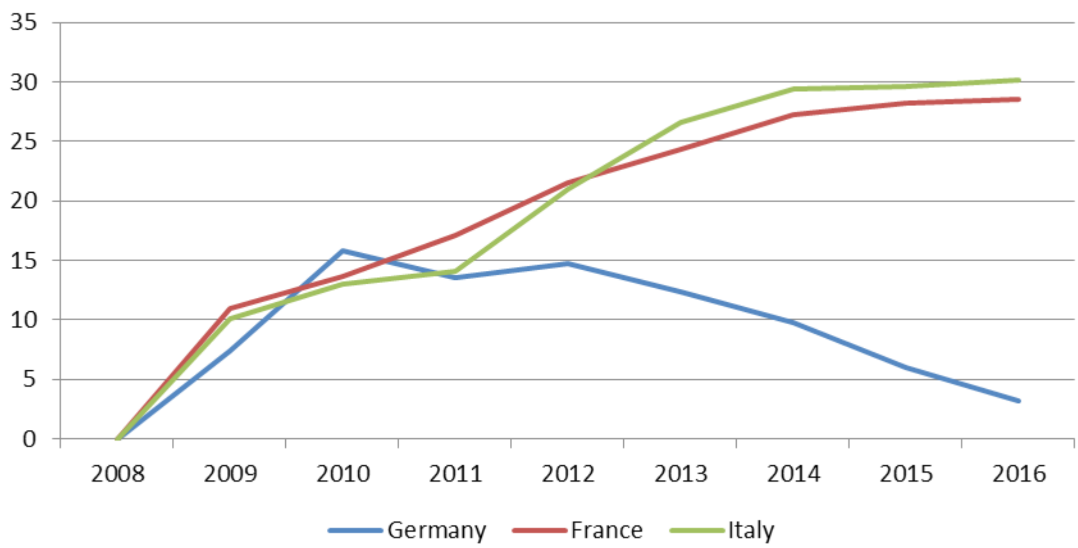
In 2008, when the crisis broke, Germany and France had very comparable debt-to-GDP ratios (65.1 % and 68.0 % respectively). However, the two countries' underlying fiscal positions were very different. As shown by their cyclically adjusted[7] government balance (-1.1 % of GDP in Germany; -4.2 % in France) and cyclically adjusted primary balance (+1.6 % in Germany and -1.4 % in France), Germany was in far better structural shape and prepared to weather the crisis. Italy's structural fiscal position was characterised, like Germany's, by a cyclically adjusted primary balance of +1.6 %. However, its cyclically adjusted government balance was lagging behind, at -3.3 % of GDP because of the weight of interest payments on sovereign debt. As we have seen, this was not enough to establish Italy's debt-to-GDP ratio below 100 % of GDP.

To sum up, in the pre-crisis period, a time of favourable economic circumstances, Germany and, more especially, Italy made efforts to enhance their fiscal positions through a strong primary surplus, whereas France did not.

After the crisis

Since the 2008 crisis the dynamics of the debt-to-GDP ratio have been very similar in France and Italy. ***Figure 4*** shows that, from 2008 to 2016, these two countries saw their respective ratios soar – compared with Germany, where the ratio steadily declined after a sharp initial increase in 2009 and 2010.

Figure 4: Cumulative debt-to-GDP variation (% of GDP) in Germany, France and Italy, 2008-2016



Data source: AMECO (last update 11 May 2017)

7 The purpose of cyclical adjustment is to make a correction for the influence of the economic cycle on the public finances and arrive at a measure that better reflects the underlying, or structural, budgetary position.

As we did in the previous section, to go deeper in the analysis, ***Figure 5*** breaks down the evolutions of debt-to-GDP ratios in their three components.

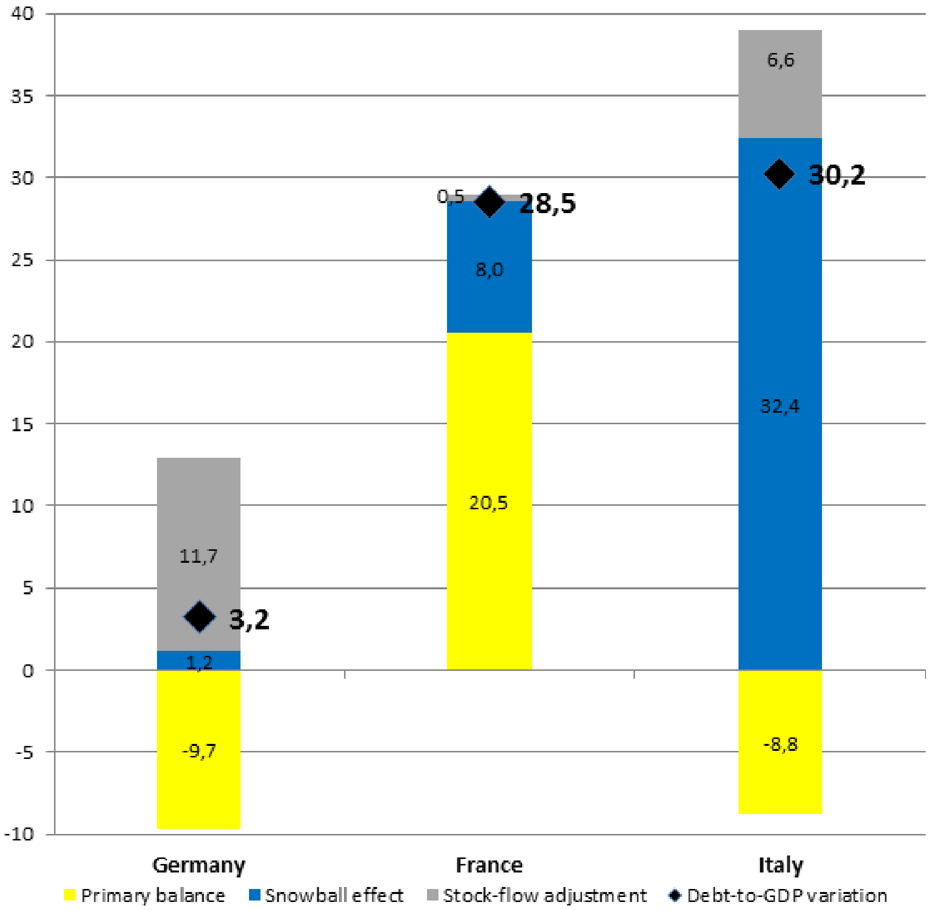
At the onset of the crisis, Italy's public debt was 102.4 % of GDP. From 2009 to 2016, the difficult economic situation was reflected in a strongly negative output gap (-2.8 % annually on average) and a yearly average nominal growth rate of just 0.3 %. Although Italy improved its structural balance (the annual average structural deficit fell to 1.9 % of GDP from 3.5 % the previous decade) and succeeded in maintaining still-positive primary surplus of 1.1 % of GDP on annual average between 2009 and 2016 (8.8% cumulated as shown in Figure 5), the debt-to-GDP ratio still rose sharply by 30.2 percentage points over the later period. This occurred because of the huge snowball effect (amounting to 32.4% of GDP cumulated over the period) resulting from a combination of a large initial stock of debt, low nominal GDP growth and high interest rates. Although Italian interest rates had been very close to Germany's ever since the introduction of the euro, the average rate on the stock of debt increased as the Italian sovereign bond market was hit by a number of shocks, and became a key contributing factor to the surge in the snowball effect after 2008[8].

France's debt-to-GDP ratio was 68.0 % in 2008. Between 2009 and 2015 France experienced a less severe economic turndown than Italy, with annual nominal growth averaging +1.4 % and an average output gap of only -1.3 %. Nevertheless, the public deficit rose considerably over the period, and averaged 4.9 % of GDP. As a consequence, despite a lower initial level of debt and better cyclical conditions, France saw an increase comparable to that of Italy in its debt-to-GDP ratio (up 28.5 percentage points). Around two thirds of this rise was due to a steady annual primary deficit of 2.6 % on average (20.5% cumulated), the remainder (8.0%) being attributable to the snowball effect. This sizable cumulative primary deficit suggests a lack of priority on deficit reduction by the French authorities. This interpretation is supported by the worsening of the country's structural fiscal position[9].

8 The Italy-Germany 10-year bond spread remained below 200 basis points (bps) until June 2011, then started to grow, peaking at over 500 bps at end 2011. The spread narrowed for a short period in spring 2012 in the wake of long-term refinancing initiated by the ECB, but widened again to more than 500 bps in July 2012. It then came down steadily to 100 bps by end 2015, but is now fluctuating at between 150 and 200 bps. For a stimulating analysis of the Italian sovereign spread determinants, see ZOLI, E. (2013) Italian Sovereign Spreads: Their Determinants and Pass-through to Bank Funding Costs and Lending Conditions, International Monetary Fund - IMF, WP 13/84.

9 Indeed, during the post-crisis period (2009 to 2016), the annual cyclically adjusted government balance was on average of -4.1 % of GDP (compared with -3.7 % from 1999 to 2008), and the annual cyclically adjusted primary balance was -2.6 % of GDP (+0.1 % from 1999 to 2008).

Figure 5: Breakdown of the debt-to-GDP variation (% of GDP), 2008-2016)



Source: Authors, based on AMECO data (last update 11 May 2017)

In Germany the debt-to-GDP ratio stood at 65.1 % in 2008. Over the 2009-2016 period Germany benefited from a higher average nominal annual growth rate (2.6 %) than France and Italy and a less negative output gap (-0.9 % on average) and only saw a very small rise of 3.2 percentage points overall in its debt-to-GDP ratio. This can be explained by the combined effect of better cyclical conditions and a protracted period of fiscal consolidation which resulted in a cumulative primary surplus amounting to 9.7% of GDP. The country experienced a very limited snowball effect (1.2% over the period) thanks to a sharp fall in the interest rate on German sovereign bonds, which were generally perceived as a safe investment during the euro-area crisis. However, the primary surplus only partially offset the high value of stock-flow adjustments (amounting to 11.7% of GDP and mainly due to financial sector support measures), which were the main drivers of the increase in debt.

Thus the post-crisis period was notable for German and Italian efforts to maintain a primary surplus. This allowed Germany to stabilise its debt-to-GDP ratio since it did not have to face down a significant snowball effect. In Italy, however, the snowball effect was far more serious and caused an increase in the debt-to-GDP ratio of about 30 percentage points. France experienced a comparable increase in its debt-to-GDP ratio, but here just one third of the rise (around 10 percentage points) was attributable to the snowball effect, the remainder (20 percentage points) being due to the lack of fiscal consolidation and the subsequent large cumulative primary deficit.

Concluding remarks

Although the debt-to-GDP ratios for Germany and France were broadly comparable at the start of the EMU, the two countries each took a radically different fiscal approach. Whereas Germany consolidated and gained competitiveness, France did not. Thus their situation rapidly diverged once the crisis broke, as only Germany was in a state of preparedness. The case of Italy is different again. Like Germany, Italy made efforts to consolidate its fiscal position, but its initial debt-to-GDP ratio was too high to allow it to cope in the same way as Germany.

Thanks to fiscal consolidation and the gain in competitiveness in the first decade of EMU, Germany was able to absorb the impact of the crisis, and its debt-to-GDP ratio is nowadays very similar to what it was in 2008. On the contrary, with a ratio exceeding 130 %, Italy is more vulnerable than in 2008, and France has now a debt-to-GDP ratio of around 100 %, which is comparable to that of Italy at the onset of the financial crisis. This situation legitimately raises concerns about the ability of the euro area, and Europe as a whole, to cope in the event of a new severe crisis.

The Commission's reflection paper regarding the Economic and Monetary Union

By Zacharias Kolias, Directorate Regulation of markets and competitive economy

The European Economic and Monetary Union has made important steps during the last decade as far as financial support, macroeconomic surveillance and banking supervision are concerned. However, as is also indicated by the audit reports in this area published by the ECA, a number of challenges remain to be addressed. Zacharias Kolias, who is the manager leading the ECA's audit team on financial economic governance issues, provides insights on the roadmap the Commission presented in December 2017 for deepening Europe's Economic and Monetary Union and on issues standing out for the future.

Summary of the Reflection Paper

On 1 March 2017, the European Commission presented a White Paper on the future of Europe. It marked the starting point for a wide debate on the future European Union with 27 Member States. To contribute further to the discussion, the European Commission put forward a number of reflection papers on key topics that will define the coming years.

This reflection paper – the third in the series – sets out possible ways forward for deepening and completing the Economic and Monetary Union up until 2025. It was drafted under the responsibility of Valdis Dombrovskis, Vice-President Euro and Social Dialogue also in charge of Financial Stability, Financial Services and Capital Markets Union, and Pierre Moscovici, Commissioner Economic and Financial Affairs, Taxation and Customs.

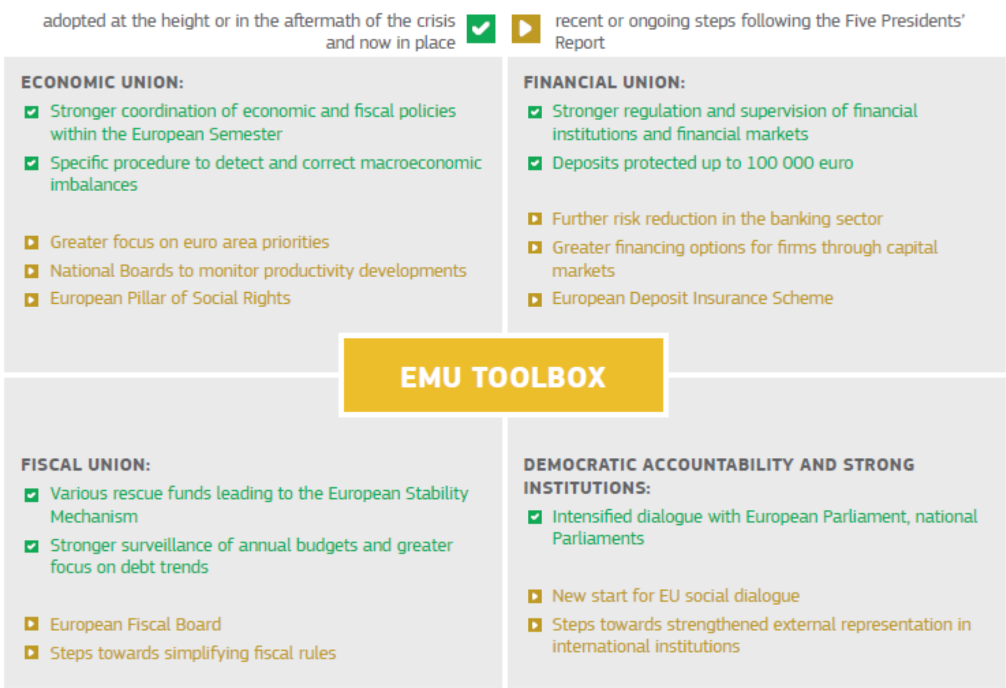
Valdis Dombrovskis, Vice-President of the EC in charge of the Euro, Social Dialogue, Financial Stability, Financial Services and Capital Markets Union, and Mário Centeno, President of the Eurogroup

The Euro is one of the most significant achievements of the EU with tangible benefits for citizens, businesses and Member States. However, the 2007-2008 financial crisis, which hit the euro area particularly hard, exposed the weaknesses of the currency and shortcomings in the ability of the EMU to respond to major shocks.

The Commission's reflection paper regarding the Economic and Monetary Union *continued*

Several steps were taken at the height or in the immediate aftermath of the crisis, in particular the creation of the European Stability Mechanism to provide financial support to Member States in difficulty, strengthened rules for macroeconomic and fiscal surveillance and a new common system of bank supervision and resolution. The instruments to strengthen the euro area are summarized in the EMU toolbox:

The toolbox of the Economic and Monetary Union today



Source: European Commission

In spite of significant improvements over the years, far-reaching legacies from the crisis persist and challenges for the euro area remain. Further steps should therefore be taken to complete the Economic and Monetary Union and thereby tackle the persisting economic and social divergences, remaining sources of financial vulnerability and high debt and to increase the collective stabilisation abilities. The actions to be taken would refer to three key areas:

Achieving a more integrated Economic and Fiscal Union

Convergence towards more resilient economic and social structures in Member States is an essential element for a successful Economic and Monetary Union in the long run. Member States could strengthen already existing elements, such as the European Semester of economic policy coordination or the link of financial support from the EU budget to structural reforms. Member States could also decide to improve the capacity of macroeconomic stabilisation of the euro area.

Completing a genuine Financial Union

An integrated and well-functioning financial system is essential for an effective and stable Economic and Monetary Union. This will involve completing the Banking Union and making progress on reducing and sharing risks in the banking sector, with measures to make European banks even more resilient. In addition progress on Capital Markets Union is essential to provide more diverse and innovative financing opportunities for the real economy.

Anchoring democratic accountability and strengthening euro area institutions

For the Economic and Monetary Union to be stronger, Member States would have to accept to share more responsibilities and decisions on euro area matters, within a common legal framework. This could be through the EU Treaties and its institutions, an intergovernmental approach or, as is the case today, a mix of both. Further political integration could involve a rethinking of the balance between the Commission and the Eurogroup and could justify the appointment of a full-time permanent Eurogroup chair, as well as unifying the euro area's external representation. The idea of a euro area Treasury – possibly with a euro area budget – as well as a European Monetary Fund are also discussed in the public debate, and could be considered at a later stage of the deepening of Economic and Monetary Union, within the EU framework.

Recent developments

In December 2017 the Commission set out a roadmap for deepening Europe's Economic and Monetary Union[1] including concrete steps to be taken over the next 18 months. The overall aim is to enhance the unity, efficiency and democratic accountability of Europe's Economic and Monetary Union by 2025.

The package includes four main initiatives:

- *Establishment of a European Monetary Fund (EMF):* Building on the ESM architecture, the EMF would continue to assist euro area Member States in financial distress and would provide the common backstop to the Single Resolution Fund and act as a last resort lender in order to facilitate the orderly resolution of distressed banks. Over time, the EMF could also develop new financial instruments, for instance to support a possible stabilisation function. The European Parliament and the Council are invited to adopt this proposal by mid-2019.

- *Integration of the substance of the Treaty on Stability, Coordination and Governance into the Union legal framework:* In 2012, the 25 signatory Member States legally committed to incorporate the substance of that Treaty into Union law five years after its entry into force, which corresponds to 1 January 2018. The European Parliament and the Council are invited to adopt this proposal by mid-2019.

- *A Communication on new budgetary instruments:* The Commission will present the necessary initiatives in May 2018 in the context of its proposals for the post-2020 Multiannual Financial Framework. The European Parliament and the Council will then be invited to adopt these proposals by mid-2019.

- *Possible functions of a European Minister of Economy and Finance,* who could serve as Vice-President of the Commission and chair the Eurogroup, as is possible under the current EU Treaties.

ECA reports

On the Economic and Fiscal Union

The reflection paper calls for structural reforms to modernise economies and to make them more resilient to stress. It furthermore highlights the importance of sound public finances, complementing common stabilisation tools at the level of the euro area as a whole for a well-functioning single currency. ECA has published a number of Special Reports (SR) in this area in recent years, the main conclusions of which can be summarized as follows:

1 Communication to the European Parliament, the European Council, the Council of Europe and the European Central Bank on "Further steps towards completing Europe's Economic and Monetary Union", 6 December 2017.

- Although the Macroeconomic Imbalance Procedure (MIP) is generally well designed, the Commission is not implementing it in a way that would ensure effective prevention and correction of imbalances (Special Report 3/2018: Macroeconomic Imbalance Procedure (MIP)).
- The Commission's intervention in the Greek financial crisis did make the progress of reform in Greece possible but the objectives of the programmes were met only to a limited extent and Greece still requires external financial support (Special Report 17/2017: Greek financial crisis).
- There are very positive signs in the Commission's efforts over the years to adapt and rationalise the excessive deficit procedure. However, it has been lacking consistency and transparency in the application of those rules (Special Report 10/2016: Excessive deficit procedure).
- The task force for Greece was a functioning mechanism for delivering and co-ordinating complex technical assistance activities but showed weaknesses in the design of some projects and mixed results in terms of influence on the progress of reform (Special Report 19/2015: Greek financial crisis).
- The Commission succeeded in managing assistance programmes to countries in difficulties but general weaknesses in handling the crisis persist: countries treated differently, limited quality control, weak monitoring of implementation and shortcomings in documentation (Special Report 18/2015: Countries in difficulties).

On the Financial Union

The reflection paper concludes that financial stability has been reinforced in the euro area but that there is still a strong link between banks and their sovereigns, that the level of non-performing loans remains high and further steps are needed to reduce and share the risks in the banking sector and to provide better financing opportunities for the real economy. ECA has published the following Special Reports on different aspects of the Financial Union:

- The ECB has established a substantial framework for crisis management for banks. However, there are some design flaws and signs of inefficient implementation that should be addressed (Special Report 2/2018: ECB crisis management for banks).
- Although the reflection paper assesses the Single Resolution Board (SRB), which was set up to ensure the resolution of banks in the EU, as 'up and running' our report concluded that it is still 'very much a work in progress', with shortcoming in the quality of rules and guidance, resolution planning for individual banks and staffing (Special Report 23/2017: Single Resolution Board).
- The complexity of the Single Supervisory System, assessed as 'fully operational' in the reflection paper, is a challenge especially since the new mechanism remains too heavily dependent on the resources of the national supervisors. Thus, despite its overall responsibility, the ECB has insufficient control over some important aspects of banking supervision (Special Report 29/20116: Single Supervisory System).
- Whilst the European Securities and Markets Authority (ESMA) has laid down good foundations, its rules and guidelines are not yet complete and significant risks remain to be addressed in the future (Special Report 22/2015: ESMA).
- The creation of the European Banking Supervisions (EBA), was an important first step in response to the financial crisis. However, some shortcomings were identified in respect of cross-border banking supervision, the assessment of the resilience of EU banks and promotion of consumer protection (Special Report 5/2014: European Banking Supervision (EBA)).

ECA's planned future work

A number of audits in relation to the Monetary Union are also included in the Annual Work Programme 2018 and will be published over the coming months:

- European Semester I & II;
- EU's venture capital interventions;
- EU-wide EBA stress tests;
- Financial crisis prevention landscape review;
- Fiscal stability in the EU.

Some questions remain to be addressed

ECA reports have identified a number of challenges that remain to be addressed in implementing various EU policies in this area. Some of the issues raised in both the ECA reports and numerous Commission publications on this topic present common arguments to the co-legislators where structural changes in design and/or implementation of policies are still needed. Some of the questions that remain to be addressed are:

- What kind of accountability framework is currently envisaged for the recently proposed European Monetary Fund, this in view of difficulties experienced in access to information, the need for consistent and comprehensive audit arrangements;

- What are the Commission proposals regarding the creation of a macroeconomic stabilisation function for the euro area as envisaged in the Five Presidents Report;

- The EU and the euro area were mostly built on nominal convergence. Real convergence is nowadays a key objective of the Union to ensure that citizens across MS benefit evenly from the EMU. What are the Commission's plans and tools to foster real convergence?

- The EMU is not considered completed yet, also in view of a persistent segmentation of financial markets and no centralised stabilising fiscal policy. This poses threats to the euro. What are the Commission's proposals to address this;

- The ECA audits in the EU economic governance area suggest that the implementation of country-specific recommendations is low, depending on Member States' good will and limited use of the enforcement tools the Commission has available What are the Commission's plans to improve this and what role does it envisage to the recently founded Structural Reform Support Service;

- What are the Commission's plans to promote simpler rules, realistic targets and more transparency in the decision-making process in areas relating to the Macroeconomic Imbalance Procedure and the Excessive Deficit Procedure.

All in all the Commission's Reflection Paper provides a welcome stepping stone to further deepen the discussion on the direction of the Economic and Monetary Union, with hopefully clear decisions on economic, supervisory and fiscal dilemmas that will ensure continued assurances for and benefits of the euro for citizens, businesses and Member States even beyond 2025.

From crisis management to auditing measures to prevent a new one

Interview with Kevin Cardiff, ECA Member

By Gaston Moonen, Directorate of the Presidency

With Kevin Cardiff leaving the ECA at the end of this month a Member with an interesting mix of experience in the financial economic governance area will leave. As rapporteur for ECA reports in this area, and also author of a book reflecting on the actions taken in the heat of the financial crisis he is willing to share his perspectives, both micro and macro, on the EU's outlook in banking and economic surveillance issues.

Executive experience in dealing with the 2008 crisis

Kevin Cardiff has been ECA Member since 2012. With his mandate finishing this month he will move on to new activities from March onwards. He has been rapporteur for several ECA reports in the financial economic governance (FEG) area, most recently for Special Report 2/2018 on the Single Supervisory Mechanism and Special Report 23/2017 on the Single Resolution Board. Before moving to Luxembourg he was Secretary General of the Irish Ministry of Finance, including at the time when Ireland was severely hit by the financial crisis from 2008 onwards. Kevin Cardiff shared his experiences during that period in his book 'Recap.'1 He chuckles when we speak about the book: 'You probably belong to a select group of people in the house who have read the book!'

When discussing with him how he now perceives the solutions brought up in the aftermath of the crisis he says: 'There are many ways of saying that the European system and the national systems should have done better in anticipating the problems that hit us. But human nature is what it is: even now we see new problems developing that people just cannot find it in their hearts to deal with. Climate change is an example of that. Climate change is a crisis that it has announced itself over 30 years before it will become a real crisis, and yet we still do not address it as if it were a present thing.'

Actions in response to the crisis

Reflecting further on the financial crisis Kevin Cardiff believes there was a broad range or reactions: 'First of all, Europe did not ignore the problem. Secondly, it made really quite substantial changes in the most fundamental policy areas to cope with the crisis. It was probably

1 Kevin Cardiff, *RECAP Inside Ireland's Financial Crisis*, Dublin 2016.

slow to move and some people indicate it was so much slower than the US. But the US has a single government in a single country. Europe is a set of countries, be it with a very close association between them, but still does not react and move in the same way as a single country.' He considers many things that happened in reaction to the crisis were positive: 'First of all in dealing with the crisis itself, but also in learning from it. Of the latter the most evident example is probably the Banking Union, and all that it entails. And now, even ten years on from the start of the crisis when things are calm, policy makers are still trying to press ahead with this agenda because it is not complete yet, because they want to learn the lessons from this previous crisis. So it is not that the lessons were immediately forgotten as soon as things got a bit better. But some of the urgency has certainly been removed.'

... even ten years on from the start of the crisis when things are calm, policy makers are still trying to press ahead with this agenda ...

Kevin Cardiff thinks that the EU made a good attempt to better policy coordination on issues like fiscal policy and macroeconomic policy. 'There are new fiscal rules, maybe not ideal yet but certainly an attempt. There are new macroeconomic surveillance procedures, called the macroeconomic imbalance procedure (MIP), which is a genuine attempt to get to grips with the problem that economic coordination in Europe across different countries is a difficult thing to achieve but it has some real benefits if it can be achieved.' He refers to ECA Special Report 3/2018 on this topic, published earlier this year: 'Even though this report on the MIP has some criticisms, you also have to see the ambition: not just coordinate more among countries, but actually be subject to a mutual surveillance and correction system. So for all the criticism that the corrections perhaps do not happen according to the rules, it is still quite a project.'

ECA acting upon a new reality

As to the ECA's role when auditing these procedures Kevin Cardiff is rather explicit: 'It is entirely appropriate for us auditors to make remarks on lacking implementation and deviation on what was foreseen in the rules. You need such assessment to improve the systems. Auditors should point out flaws. But it is really up to politicians to decide whether to address them in the context of their moral judgement and their judgement of what their populations want. Politics should react on technical matters where they are important enough. But auditors should be ultimate technicians bringing attention to problems that need to be solved.

Auditors should point out flaws. But it is really up to politicians to decide whether to address them ...

When looking back at how the ECA reacted to the crisis Kevin Cardiff underlines: 'As ECA we clearly had a new problem to address. We did not have all the skills we needed to address it. So there was initially something really important about setting up a special team. As such that is a good model. But it is not a model that can last for 20 years because you cannot have a task force that is also a very long term task force.' He explains that if a particular area of work becomes normal rather than an emergency, then it should be normalised: training staff for the area of work, rather than assume that it is essential to always bring in people from outside. 'You are then in an area of continual development rather than initial learning.'

As to his own adaptation from working as Secretary General at national level to working as an ECA Member Kevin Cardiff remarks: 'Most of the skills I had picked up were directly transferable: analysis, understanding of conflict issues, ability to engage with people and understanding of bureaucratic systems.' As to differences he believes that procedurally the ECA is probably more robust than his previous organisation. 'But this goes a bit at the cost of flexibility. However, I am glad that the ECA has addressed some of these in recent years. And the FEG team is an example of that: a flexible response to an external environmental change.'

What was new to him was the collegiate structure of the ECA with 28 Members. 'In my previous job I was a Secretary-General, so in effect a chief executive of a ministry, reporting to a minister. But one thing that you learn as senior executive is that all your influence, all of your power, operates by consent of your staff and colleagues. It just does not work to be directive and say exactly what each person has to do each day because you cannot possibly be so omnipresent as to make that work. So you rely on people's trust and professionalism. And when you do that you also rely on their consent.' Kevin Cardiff believes that in every organisation, consent, or at least acceptance of colleagues, is something you have to achieve. 'In the ECA structure that has to be achieved one level higher because of its collegiate nature. But it turned out not as different as I expected.'

> *... one thing that you learn as senior executive is that all your influence, all of your power, operates by consent of your staff and colleagues.*

EU operating in consent

Consent is also important in how Kevin Cardiff sees the EU operating: 'The EU is a democratic institution, or should be. And democratic institutions don't get to make the rules that the technocrats want. They must have to make rules according to what people want. In a democracy that operates as a federation of Member States it is even more complicated: you must operate by the consent of each MS and therefore need democratic buy-in, not just globally but from each MS concerned.' Kevin Cardiff can imagine several areas where Europe could have a more logical system that is perhaps better designed technically. 'But not everybody in the MS wants those developments. And they are entitled in a democracy to have a different view!'

For the future he expects that democracies will increasingly have to address a major issue which becomes more and more pertinent: inequality. 'All the major democracies are more prosperous than 50 years ago, but they are not necessarily to be more equal. And this is likely going to put a strain on the democratic system in the future. It is not Europe's job to go further and faster than its people want. We should set out an example, we should point to possible directions, but we should not bring people along without their consent. And I don't think there is consent yet for all of the things that might, from a technical point of view, be desirable.

> *All the major democracies are more prosperous than 50 years ago, but they are not necessarily to be more equal. And this is likely going to put a strain on the democratic system in the future.*

Preventive measures give confidence

Can something like what happened with the crisis happen again, a question Kevin Cardiff also raises in his book. 'Certainly a financial crisis could happen again but it should not happen soon. If it happens again the European system is better structured than it was. Each MS should have better protections than it had, including additional forewarning. While people are often capable of making the same mistake twice I believe we have seen a lot of learning in the European system, and the national systems. So we will not walk in exactly the same crisis again.' However, he believes that a crisis can come upon you when you are still somewhat unprepared. He elaborates: 'One does not know what the crisis could be: a flu epidemic, a defence crisis, another financial crisis. We already have a migration crisis. All this is possible. That much is clear: Europe will find itself in a crisis again but most likely, if there will be a financial crisis, it will come in a different form. Certainly our banks' capital base is much better prepared, also our institutional system is better prepared.' He believes that if a similar crisis happens again, it would have a less severe impact.

> *... I believe we have seen a lot of learning in the European system, and the national systems. So we will not walk in exactly the same crisis again.*

As to the idea of the ECA making a landscape review in the area of financial economic governance, Kevin Cardiff thinks this could be an option. 'But the ECA would have to see where it can provide most added value. There is no point repeating the work of decent economists or financial specialists. However, there would be value in bringing together the key lessons of our FEG audits and present in an integrated way the various conclusions we have drawn and put them in a broader context.' He adds that the ECA should do this from time to time in several areas, provided that its basic audit work is solid and extensive enough: 'Only when we are sure that our core audit work is convincing we will be trusted as an advisor on broader policy matters. Our prime job remains audit.'

Only when we are sure that our core audit work is convincing we will be trusted as an advisor on broader policy matters. Our prime job remains audit.

Completing the Economic and Monetary Union

His view on where the focus of the ECA's activities needs to be surfaces also when discussing the Commission's roadmap proposals for completing the EU Economic and Monetary Union. 'As an audit body we should be fiercely ambitious about doing our work well. We should be careful about stepping into this space of policy makers because that is not our basic role. But there is a link. And that is analysis. We provide for the EU system an analysis that is independent and hopefully of expert value. And that should inform policy discussions. So we should always be available and anxious to show where our technical audit work can inform a policy consideration. We should not try to force the policy agenda along whatever line our opinion might be. We should more try to insist that the policy lessons that are there from our analysis are properly considered in the policy development process.' Kevin Cardiff considers the FEG area a good example of that. But there is also our work on agriculture. 'For example our audit on young farmers, Special Report 10/2017: really interesting and addressing a central plank of the policy mix. In view of that it should be considered when the next round of policy making is taking place, which actually is quite soon.'

We provide for the EU system an analysis that is independent and hopefully of expert value. And that should inform policy discussions.

Kevin Cardiff remarks that the name economic and monetary union sounds that it is all about economics. 'But in most of the countries concerned it is very much a political project. At least it was as much driven as a political project. And that surfaced some inherent contradictions. We have a currency structure developed as if we have a single country but we do not have a single country. And that probably means some potential for creating some instabilities.'

He observes that there is a monetary policy mix which is not necessarily designed with people who are designing fiscal policy, which then varies across the Member States. 'And there are no structures for insulating individuals from this problem of divergent policy mixes. It is very important and very encouraging that there is a debate about this in Europe: how do we deal with this inherent set of contradictions!' As to why this is so encouraging he continues: 'Because we want to learn from the past. The lesson of the last decade is that our systems have many positive aspects but also issues that need to be addressed. The difficulty is addressing them in a way that is democratically acceptable. And we do not have a situation yet that people are prepared, in many Member States at least, that they consider themselves as equally responsible for the fate of fellow citizens at the other side of the Union as they are for those who are right beside them. We are not at the point where people think in those terms so we are not yet at the point where we can have an EU structure that comes even close to that of a nation state.' Then he concludes: 'Europe needs not to build structures of a nation state but structures that can allow it to have the benefits of a nation state while retaining the diversity and national level autonomy that it does have.'

... our systems have many positive aspects but also issues that need to be addressed. The difficulty is addressing them in a way that is democratically acceptable.

EU problems going beyond institutional capabilities

As to the question whether there are external development which require solutions going beyond the institutional capabilities Kevin Cardiff has to think: 'This is probably true. One reads that people are disappointed with the EU because it did not cope with x. y or z. Very often these are issues which Europe was not intended to cope with and which are beyond its remit. It is interesting and a sign of integration that people somehow expect that in any area where there is a major cross-border problem that it is the EU's job to fix it. This is a challenge for the future: these cross-border crises that arise in various fields do not just test the European structure but also Europe's ability to develop to meet new potential demands.' For Kevin Cardiff the real strength of the EU is that it exists and is ready to take on new tasks. 'But each time it does that it has to ask itself: how much of this task is for Europe and how much is for the national level. And what usually happens is: when there is a problem people will say: let the EU help and solve it. But when there is not a problem, the same people will say: let the EU stay out.' He believes this typically happens when people have different incentives at different times.

> *It is interesting and a sign of integration that people somehow expect that in any area where there is a major cross-border problem that it is the EU's job to fix it.*

Taking along good experiences

Looking forward for his own future Kevin Cardiff indicates he has several plans: 'I want to do some academic work and also get engaged in the private sector. This would be a first because in the past I often engaged with them but never really worked inside the private sector. And I also would like to find some ways to contribute in the public interest.' He reflects that it is not all designed and worked out yet. 'I expect and hope to have not one but a small range of activities.'

To the question what Kevin liked most when looking back at his years at the ECA he is very resolute: The colleagues in our organisation. They offer such a fascinating range of cultures, expertise, personalities and almost all of them positive thinkers with a real desire to help the EU to be better.' He also has a but: 'Of course they are all trained sceptics, and for the ECA, or its Secretary-General to manage staff who are all trained sceptics or even cynics, this is a challenge.' He laughs, saying that nothing that the ECA College or the Secretary-General do goes without a detailed analysis in the canteen. 'But that is also positive. Overall I dare to say: I have made some good friends here!'

> *The colleagues in our organisation. [...] almost all of them [are] positive thinkers with a real desire to help the EU to be better.*

Annual Meeting of the College of Commissioners with the ECA

By Kathrin Börnemeier, Directorate of the Presidency

President Jean-Claude Juncker and 19 Commissioners, among them First Vice-President Frans Timmermans, came to Luxembourg on 5 February 2018 to meet with the ECA's Members and discuss topics of common concern to both institutions. The meeting centred on the Commission's 2017 Future of Europe reflection papers. Kathrin Börnemeier provides some details.

Klaus-Heiner Lehne, ECA President and Jean-Claude Juncker, European Commission President

Annual meeting between the Commissioners and the Members of the ECA are now a tradition. This year's meeting took place on 5 February 2018 at the ECA premises in Luxembourg. The discussion focused on the future of the EU's finances and the next Multiannual Financial Framework (MFF), but Commissioners and Members also used this opportunity to exchange views on a wide range of other issues.

This year the half-day meeting followed a new format. First, there was a main subject: the Commission's reflection papers on the future of Europe, which had been published in the first half of 2017. Secondly, the meeting was organized in a more interactive way providing additional opportunities to meet and discuss.

EC President Jean-Claude Juncker and ECA President Klaus-Heiner Lehne both made opening statements to set the scene and launch the discussions, followed by a keynote address by Commissioner Oettinger. Subsequently, there were parallel sessions during which Commissioners and Members discussed specific issues raised in the Commission's reflection papers on social matters, economic and monetary union, defence, globalization, and the future of EU finances. The 2017 annual meeting took place in a spirit of mutual respect and appreciation, and the issues raised during the discussions will provide additional input for the ECA's ongoing work on the next MFF and its programme for 2019.

Jean-Claude Juncker signing the ECA Golden Book

Annual meeting between the Commissioners and the Members of the ECA, 5 February 2018 at the ECA

2018 annual meeting of European Parliament's Committee on Budgetary Control and the ECA

By Corina-Maria Rusanescu, Directorate of the Presidency

The European Parliament's Committee on Budgetary Control (CONT) is a crucial partner to ensure a public discussion of the ECA's audit findings, conclusions and recommendations and to promote a political follow-up of our audit work. Each year a joint meeting is organised to have an exchange of views on matters of general interest. Corina-Maria Rusanescu reports on the recent annual meeting which took place on 1 February 2018 in Brussels.

Ingeborg Grässle, Chairwoman of the CONT Klaus-Heiner Lehne, ECA President and Eduardo Ruiz García, ECA Secretary-General

Annual meeting provides a forum to discuss matters of common concern

It goes without saying that he Committee on Budgetary Control (CONT) is one the ECA's main partners at the European Parliament (EP). In particular, annual and special reports serve as basis for the EP's yearly discharge exercise which falls under the responsibility of CONT. As a general rule, the ECA Members are invited to present their reports in CONT meetings and to reply to questions raised by Members of Parliament (MEPs) regarding our audit findings, conclusions and recommendations.

It has also been a practice for many years that the CONT MEPs meet the ECA Members and the Secretary General once per year to discuss their respective ongoing work, joint activities when this can achieve greater impact, but also any topical issues and matters of common concern. Unlike in previous years, the annual meeting between the two parties took place in early February 2018 rather than October/November (and thus coinciding with ECA's presentation of its annual report to the EP). In addition, this year's meeting was held in Brussels instead of Luxembourg.

Discussion focussed on forward looking topics

Ingeborg Grässle (Chairwoman of the CONT) welcomed President Klaus-Heiner Lehne, the ECA Members and our Secretary General, and underlined the good cooperation. She also appreciated the fact that the annual meeting, which takes place 'in camera' (i.e. not open to public), provides an excellent forum for a constructive dialogue in the spirit of mutual trust.

2018 annual meeting of European Parliament's Committee on Budgetary Control and the European Court of Auditors *continued*

During two hours, the discussions focussed on

- the ECA's strategy for 2018-2020 and challenges ahead;
- the post 2020 Multiannual Financial Framework (MFF);
- potential and challenges for country-specific reporting in performance and compliance auditing, including the ECA's new approach for cohesion policy spending;
- the way forward for ECA's reporting on EU agencies;
- the reform of the ECA's organisational structure and working methods; and
- the accountability and transparency arrangements for all EU finances and bodies, including those created through agreements outside the EU legal order to implement EU policies.

Each topic was introduced by an ECA Member in order to provide the background to the issue.

In particular, MEPs were eager to know more about the 2018-2020 strategy, particularly on the ECA's objective to increase further the added value of our Statement of Assurance and any potential changes on how we audit the EU budget. The MEPs were also informed about an on-going pilot with a modified approach in the ECA audits of Cohesion spending where we rely increasingly on the information on the legality and regularity reported by Member States and validated by the Commission. The CONT Committee was also keen to discuss to what extent their discharge vote, including for the agencies, could be brought forward.

The EP President, Antonio Tajani, joined President Klaus-Heiner Lehne, Ingeborg Grässle, the ECA Members and the other MEPs for a standing working lunch to continue the morning's discussions.

Klaus-Heiner Lehne, ECA President and
Antonio Tajani, EP President,

ECA Conference on EU Financial Instruments organised jointly with the Lithuanian Ministry of Finance

By Niamh Carey, Private Office of Rimantas Šadžius, ECA Member

Left to right: Wilhelm Molterer- Managing Director of EFSI , Loreta Maskalioviené- Vice Minister of Finance of the Republic of Lithuania, Rimantas Šadžius- Member of the European Court of Auditors, Vilius Šapoka- Minister of Finance of the Republic of Lithuania, Iliana Ivanova- Member of the European Court of Auditors, Vazil Hudák- Vice President of the European Investment Bank, Arnoldas Pranckevičius- Head of European Commission Representation in Lithuania

#ECAFinInstrLT

The ECA's audit findings regarding financial instruments published in recent years received a lot of interest across the EU. Financial instruments remain high on the agenda, not the least since the Commission intends to increase their use in the next Multiannual Financial Framework. This is why the ECA, together with the Lithuanian Ministry of Finance, took the opportunity to host a conference on financial instruments, which looked specifically at implementation issues in Member States. Niamh Carey looks back at the conference that took place in Vilnius on 26 January 2018.

Bringing together a diverse audience

During the 2014-2020 period, financial instruments (i.e. the financial support provided directly or indirectly from the EU budget through loans, equity investments or guarantees) have remained high on the agenda. In particular, since it is well known that the Commission intends to propose an increased use of this form of repayable financial support for the next Multiannual Financial Framework (MFF).This is why the European Court of Auditors and the Ministry of Finance of the Republic of Lithuania held a joint conference on EU Financial Instruments on Friday 26 January 2018 in Vilnius. A specific focus of this conference was to share experiences made at national level in the implementation of these instruments.

The event gathered a very diverse audience with various interests across many fields; from high-level experts from European and national level, to representatives of private enterprises and public institutions working in Lithuania and other Member States such as Poland, Slovakia, Latvia, Croatia, Hungary, Romania, Spain and Ireland.

Key speakers were, among others, the Minister of Finance of Lithuania, Vilius Šapoka, and Vice-Minister Loreta Maskalioviené. Vazil Hudak, Vice-President of the European Investment Bank (EIB), Wilhelm Molterer, Managing Director of the European Fund for Strategic Investments (EFSI), and Arnoldas Pranckevičius, Head of the European Commission Representation in Lithuania, also made key speeches. From the ECA side, Iliana Ivanova, reporting ECA Member for ECA Special Report No 19/2016 on financial instruments, and Rimantas Šadžius, the ECA Member responsible for ECA institutional relations, shared their views on how financial instruments can be used most effectively by Member States.

The first part of this one-day conference focused on general aspects of the implementation of financial instruments in the Union. In the afternoon, participants dealt with the practical application of financial instruments in both the public and private sectors in Lithuania, as well as with a case study of financial instruments in Poland. The discussions were moderated by the ECA's spokesperson, Mark Rogerson.

Why a conference on this topic in Lithuania?

Lithuania, like many other Member States receive a large amount of EU financial support within the Cohesion policy framework. Financial instruments, which share the characteristic that the money must be paid back, account for an increasingly important share of this EU support. In fact, revolving forms of finance make such support more sustainable over the longer term. Financial instruments, however, also have a leverage effect. They have the capacity to combine different forms of public and private resources.

Left to right: Wilhelm Molterer, Vazil Hudák, Loreta Maskalioviené, Iliana Ivanova and Rimantas Šadžius

How to best use ECA' work to add value in implementing EU policies on the ground

EU Financial Instruments are implemented by nearly all Member States and involve many actors from the public and private sectors. A good understanding and cooperation between those in charge of policy design, those implementing the instruments and those auditing them is essential for the successful uptake and future growth, especially when planning the new MFF post 2020. With a focus, in particular, on how EU financial instruments can be used efficiently to pursue the Union's policy goals, the conference was a good opportunity for experts from the EU institutions, practitioners and other public and private stakeholders, including start-ups, to exchange views and ideas.

The starting point and background of the debate was the audit the ECA did in 2016. Iliana Ivanova presented the main findings of ECA Special Report 19/2016 'Implementing the EU budget through Financial Instruments – lessons to be learned from the 2007- 2013 period.' The discussions that followed showed that the ECA's analysis presented in this report, on the functioning of EU financial instruments and difficulties found in applying these mechanisms, still remains valid today and lessons learnt from this analysis could help in designing and implementing more effective instruments in the future.

ECA Conference on EU Financial Instruments organised jointly with the Lithuanian Ministery of Finance *continued*

Organising such a conference in a Member State, and in partnership with a national authority, was significant as it is part of the ECA's overall strategy for the 2018-2020 period. Moreover a key element of the conference was to reach a wider range of stakeholders and to extend the work of the ECA and to adapt it to the specific needs of the audience. The challenge is to fit the findings and the expertise that we collected in the ECA to the real needs of practical policies in different EU Member States. Furthermore, the conference was an excellent opportunity for practitioners and auditors to share good practices on the basis of ECA audit reports and learn from past mistakes.

ECA team involved in organising the conference:
left to right: Michal Szwed, Tomas Mackevičius, Mindaugas Pakštys, Niamh Carey, Rimantas Šadžius, Aušra Maziukaitė, Mark Rogerson, Alexandra-Elena Mazilu, Fabrice Mercade, Juan Blanco Arellano

Reaching out

Prime Minister of Thuringia visits the ECA

By Roberto Gabella Carena, Directorate of the Presidency

Bodo Ramelow, Prime Minister of the German Bundesland Thuringia and Klaus-Heiner Lehne, ECA President

Germany is one of the EU Member States which is a federal state. EU funds and programmes are generally managed at the level of the regions and thus subject to audits by the European Court of Auditors. Roberto Gabella Carena reports on a visit from the Prime Minister of Thuringia to discuss matters relating to the management and the audit of EU funds in his region.

On 5 February 2018 ECA President Klaus-Heiner Lehne welcomed Bodo Ramelow, the Prime Minister of the German Bundesland, visited together with the German Ambassador, Heinrich Kreft the ECA for an exchange of views about the use made of EU funds in the Eastern part of Germany, and the positive results achieved in his region thanks to this support.

During the 2014-2020 period, Thuringia has set up a regional ERDF operational programme with around € 208 million expenditure per year and an ESF programme with around € 89 million, each co-financed at 80% from the EU budget. In the agricultural sector, Thuringia received around € 214 million under the EAGF and another € 97 million for rural development (EAFRD) in 2017.

The meeting provided an opportunity to discuss good practices in managing and making best use of the financial support provided from the EU budget and the specific role of the regional audit offices (Landesrechnungshöfe) in auditing EU funds. President Lehne gave some background information on the ECA's audit approach in these two areas of shared management and ECA's cooperation with the Supreme Audit Institutions (SAIs) and regional audit bodies in the Member States, including the coordination and cooperation on audits.

Prime Minister Ramelow also shared his experience in relation to an inter-regional cooperation project with Greece in the field of professional training. This agreement would have allowed unemployed young Greeks to undertake a professional training in companies in Thuringia, co-financed by the European Regional Development Fund. So far, this programme has however not yet been put into place due to administrative difficulties. Finally, he presented the views of his government on the future of the EU budget, and on how the specific circumstances of the agricultural sector in East Germany and his region could be better reflected in the post-2020 regulatory framework of the CAP.

Klaus-Heiner Lehne, ECA President; Martin Weber, ECA Director; Susanne Meyer Head of Protocol, Thuringian Minister-President office; Torsten Weil, Head of Cabinet, Thuringian Minister-President office and Bodo Ramelow, Prime Minister of the German Bundesland Thuringia

ECA discusses recent ECA report on EU Election Observation Missions with 'International IDEA' in Stockholm

By Kristina Maksinen, Directorate External action, security and justice

From left to right: Gideon Nhundu, Yves Leterme, Therese Laanela, Virginia Beramendi-Heine, Elizabeth Kakai, Keboitse Machangana, Turo Hentilä, Ville Itälä, Kristina Maksinen

A key message in ECA Special Report 22/2017 was that better consultation with stakeholders on the ground is needed to maximise impact of the EU's election observations. The head of task, Kristina Maksinen, reports on a recent meeting with International IDEA, an organisation that can help putting this recommendation into practice.

The EU observes elections all over the world as a means of promoting democracy, human rights and the rule of law. Approximately two months after Election Day, EU election observers make recommendations to the host country for electoral framework improvements. The ECA assessed the support provided for the implementation of such recommendations, using four countries as case studies: Ghana, Jordan, Nigeria and Sri Lanka.

On 2 February 2018, an ECA delegation visited the International Institute for Democracy and Electoral Assistance (International IDEA) in Stockholm to present the ECA Special Report 22/2017 '*EU Election Observation Missions – efforts made to follow up but better monitoring needed*' and to discuss its findings and recommendations. International IDEA is an intergovernmental organisation which mission is support sustainable democratic change through providing comparative knowledge, assisting in democratic reform, and influencing policies and politics. The ECA representatives (Ville Itälä, ECA Member; Turo Hentilä, Head of Private Office, and Kristina Maksinen, Head of Task) were welcomed by the Secretary-General of International IDEA, Yves Leterme; Gideon Nhundu, Acting Director of Corporate Services; Keboitse Machangana, Director of Global Programme; Therese Laanela, Senior Programme Manager for Electoral Processes; Virginia Beramendi-Heine, Programme Officer for Electoral Processes;; Elizabeth Kakai, Head of Internal Audit; and Annika Silva-Leander, Senior Advisor to the Secretary-General.

During the meeting with International IDEA we covered several aspects of the report including its relevance to the work of International IDEA. The International IDEA participants very much welcomed the focus on follow-up to EU Election Observation Missions, stressing that while it is important to assess the events around Election Day, there is a need for considering the full Electoral Cycle. This includes activities such as political dialogue and electoral assistance. The importance of involving EU Delegations on the ground in this respect was particularly mentioned as an important part of the follow-up.

The Hague and the Golden Age: Accounts, Accountability and Auditors

By Peter Welch, Directorate Sustainable use of natural resources

Fair on the Buitenhof square in The Hague in the XVII century
De Haagsche Kermis, Inter-Antiquariaat Mefferdt & De JongeDaniël Marot - Inter-Antiquariaat Mefferdt & De Jonge, CC BY-SA 3.0

View on the Buitenhof in The Hague of today
Buitenhof tegenover de Hofvijver, Geschiedenis van Den Haag

In a historic environment in The Hague representatives of 16 Supreme Audit Institutions came together to discuss innovation in accounting and future perspectives. Our colleague Peter Welch was invited to moderate the discussions and he brings us up to date on the key points raised.

Improved accounts as a building block for progress

In The Reckoning – an account of the historic significance of the adoption of double entry bookkeeping in public accounts - Professor Jacob Soll picks the Dutch Golden Age as a key case study. Improved accounts (building on the insights of Luca Pacioli) led to better planning and control, and to a culture of accountability. This in turn led to the Golden Age of the Dutch Republic. So it was good to discuss public sector financial reporting reform with representatives of 16 EU Supreme Audit Institutions (SAIs), at a meeting on 1 February 2018, hosted by the *Algemene Rekenkamer* (Netherlands Court of Audit), in The Hague's historic Buitenhof, with Golden Age buildings around us. And it was a special honour to be asked to moderate the discussions on this important theme.

Arno Visser, President of the Algemene Rekenkamer, is keenly aware of the history of Dutch innovation in accounting. His opening address focussed on the case for accrual accounting as a means to improved accountability, democracy, and decision-making. Ewout Irrgang, Member of the Board of the Algemene Rekenkamer set out the case for progress in his moving closing address. The Netherlands is one of a relatively a small number of EU Member States where accrual accounting is not used by the central government ministries (it is widely used at other levels of the public sector and by specific executive units at central government level - called 'agencies'), and Martin Dees, also of the Algemene Rekenkamer, told us about the outcome of the work an advisory committee on Dutch central government accounts that has recommended to move the story forward.

Key points discussed

Much of the day was devoted to a discussion between the representatives of the SAIs on experience in their Member States, and their attitude to accrual accounting and further reform. This is my perception of the key points made.

- most EU Member States have moved – or are moving – to accrual accounts. And most SAIs are positive about this move;

- few SAIs believe that the process of reforming accounts is over – even those coming from Member States that have already done the most believe that there are further challenges ahead;

- advocates of accrual accounting tended to be relatively relaxed about the options of following International Financial Reporting Standards (IFRS), International Public Sector Accounting Standards (IPSAS), or local commercial practice: financial statements prepared on these different bases can be very similar;

- the changes to the governance of the IPSAS Board (with the creation of an independent oversight board on which SAIs are represented) mean that IPSAS now has more support than in the past.

- there are a variety of views on the European Public Sector Accounting Standards (EPSAS) project (which was not the principal subject of debate). Some SAIs think it might represent a significant step towards far-reaching harmonisation of public sector accounting in the EU. Several others are more cautious about the project. There is a widely shared view that the EPSAS project has big implications for audit (and for auditors) that have been largely left out of the debate to date;

- some SAIs expressed surprise that statisticians do not make more use of audited financial information when drawing up statistical information. There was appreciation for the moves accounting standard setters have taken to align – where practical – with statistical approaches. Some SAIs thought statisticians could do more to reciprocate;

- one of the SAI representatives in The Hague is a member of the IPSAS Board. Still SAIs would like further contact with and consultation from standard setters; and

- future challenges include producing consolidated accounts covering a wider range of central government, using accrual information for budgeting purposes, harmonising accounting treatment across different levels of the public sector, and (in particular in those Member States without accrual accounting) covering all categories of assets and liabilities in the financial statements.

In principle, this was a one-off meeting. But there was widespread interest in staying in touch, to share information on projects of common concern (like EPSAS), to share views on exposure drafts from standard setters (perhaps with a presentation on current issues), and to address difficult accounting issues that affect several SAIs. Many of us will be waiting with interest to hear what our hosts, the Algemene Rekenkamer, reports back to the EU Contact Committee of SAIs.

Publications in January 2018

Background paper

Published on 9 January 2018

Background paper: Animal welfare in the EU

The European Court of Auditors is currently examining whether action by the European Commission and the Member States has made an effective contribution to achieving the EU's animal welfare objectives.

Click here for our report

Special report N° 01/2018

Published on 11 January 2018

Joint Assistance to Support Projects in European Regions (JASPERS) – time for better targeting

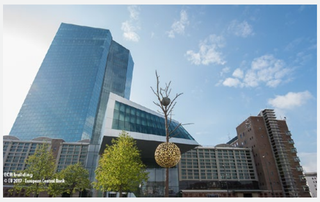
In 2006, the European Commission engaged together with the European Investment Bank in a new initiative, known as 'Joint Assistance to Support Projects in European Regions' (JASPERS). Its main aim was to provide independent free-of-charge advice to help the Member States that joined the EU in 2004 or later to prepare high-quality 'major projects'. We found shortcomings in the definition of JASPERS's main objectives and roles and responsibilities, which put accountability at risk. There were also significant weaknesses in the setting-up of the new Independent Quality Review function, leading to a high risk of lack of impartiality. While JASPERS contributed to quicker project approval and better quality of underlying project documentation, it could generally not impact on the absorption of EU funds. Its impact on Member States' administrative capacity did not yet result in higher degrees of independence from JASPERS's assistance. The observed weaknesses, in combination with significant shortcomings in the planning, monitoring and evaluation of JASPERS activities, put at risk the successful operation of the initiative, particularly in terms of efficiency and effectiveness.

Click here for our report

Publications in January 2018

Special report N° 2/2018

The operational efficiency of the ECB's crisis management for banks



Published on 16 January 2018

The European Central Bank (ECB) assumed responsibility for banking supervision in 2014, as part of the establishment of the Single Supervisory Mechanism. Its mission in this regard is to contribute to the safety and soundness of the banking system. There are about 120 banking groups in the euro area under the ECB's direct remit, while other banking groups are supervised by national supervisors in close co-operation with the ECB.

This audit assessed the operational efficiency of the management of the ECB in relation to one specific supervisory task: crisis management. We find that the ECB has established a substantial framework for crisis management. However, there are some design flaws and signs of inefficient implementation that should be addressed.

We make a number of recommendations relating to making better use of recovery plan assessments and developing operational guidance for crisis management activities and enhance management reporting systems.

Click here for our report

Special report N°03/2018

Audit of the Macroeconomic Imbalance Procedure (MIP)

Published on 23 January 2018

We examined the European Commission's implementation of the Macroeconomic Imbalance Procedure, which aims to identify, prevent and address macroeconomic imbalances that could adversely affect economic stability in a particular EU country, the euro area, or the EU as a whole. We found that although the MIP is generally well designed, the Commission is not implementing it in a way that would ensure effective prevention and correction of imbalances.

The classification of Member States with imbalances lacks transparency, the Commission's in-depth analysis despite being of a good standard has become less visible and there is lack of public awareness of the procedure and its implications. We therefore, make a number of recommendations to the Commission to substantially improve certain aspects of its management and to give greater prominence to the MIP.

Click here for our report

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Street art by Achilles. Photo: aesthetics of crisis. Used under Creative Commons BY-NC-SA (cropped)/ Desaturated from original

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