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This Financial System Stability Assessment on the **Kingdom of the Netherlands—Netherlands** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in **August 2004.** The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Kingdom of the Netherlands—Netherlands or the Executive Board of the IMF.

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Kingdom of the Netherlands—Netherlands

Financial System Stability Assessment

Prepared by the Monetary and Financial Systems and European Departments

Approved by Michael Deppler and Ulrich Baumgartner

August 9, 2004

This Financial System Stability Assessment (FSSA) is based on work of the Financial Sector Assessment Program (FSAP) team, whose two main missions to the Netherlands were in October/November 2003 and March 2004. The FSAP findings were further discussed with the authorities during the Article IV consultation mission in May/June 2004.

The FSAP team comprised Mark Swinburne (mission chief), Scott Roger (deputy mission chief), Ian Carrington, Thordur Olafsson, Leslie Teo, and Mary Wilson (all IMF/MFD); Kazunari Ohashi (IMF/ICM), David Hofman (IMF/EUR); Margaret Cotter (IMF/LEG); Michael Hafeman (formerly OSFI, Canada); Jean Moorhouse (FSA, U.K.); Richard Pratt (formerly FSC, Jersey); and Jan Schullerqvist (Riksbank, Sweden). In addition, Mr. Jack de Kluiver (independent AML/CFT expert, Department of Justice, USA) helped undertake the AML/CFT assessment. The FSAP team received excellent cooperation from the authorities and market participants. The main findings of the FSAP are:

- Overall, the financial system is sound, resilient to potential adverse shocks, and well supervised. Risks both on the international front and domestically appear well within the capacity of the banks to manage them. The pensions sector, though still sensitive to significant equity price reversals, is in a rebuilding stage, underpinned by firm supervisory action.

- Strategic and medium-term challenges include the need for banks to continue to address relatively limited domestic profitability, and to ensure they are well placed to deal with the continuing process of international consolidation; for the authorities to continue to deal effectively with the growing complexities arising from several very large financial conglomerates with substantial international activity; and for the government to review aspects of its support for housing finance.

- A pending overhaul of financial supervision legislation will strengthen the already high-standard supervisory regime and formalize the well-designed organizational restructuring of supervision on a sectorally integrated basis.

The main authors of this FSSA are Messrs. Swinburne, Roger, and Teo, with contributions from the rest of the FSAP team.

FSAPs are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross-border contagion. FSAPs do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

Contents **Page**

Glossary

ABP	Algemeen Burgerlijk Pensioenfonds (Civil Service Pension Fund)
AFM	Autoriteit Financiële Markten (Authority for Financial Markets)
ALM	Asset and liability management
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
ASCS	Act on the Supervision of Credit Institutions
BCP	Basel Core Principles for Effective Banking Supervision
CLS	Continuous Linked Settlement (a private foreign exchange settlement organization)
CoB	Conduct of business
CSD	Central Securities Depository
DNB	De Nederlandsche Bank (Netherlands Central Bank)
DTCs	Short-term Netherlands government bills
DUTA	Disclosure of Unusual Transactions Act
DVP	Delivery versus payment
ECB	European Central Bank
ESCB	European System of Central Banks
EU	European Union
FIs	Financial institutions
FTK	Financieel Toezichts Kader (new solvency framework for insurance companies and pension funds)
IAIS	International Association of Insurance Supervisors
IOSCO	International Organization of Securities Commissions
ISA	Identification of Services Act
LCFIs	Large and complex financial institutions
LTV	Loan to value (ratio)
MBS	Mortgage-backed securities
NPLs	Non-performing loans
PSW	Pension and Savings Fund Act
PVK	Pensioen-en Verzekeringskamer (Pension and Insurance Supervisor)
SMEs	Small and medium-size enterprises

Executive Summary

The Netherlands financial system is dominated by a few internationally active, large complex financial institutions (LCFIs), a situation bringing both stability benefits and several potential risks and policy challenges. Such institutions have substantial risk diversification. But, coupled with the very open nature of the Dutch economy, they make the domestic system more sensitive to global economic and financial trends. The scope for cross-sectoral spillovers is also higher, and each LCFI is systemically important from the purely domestic perspective. Currently, the main domestic risks are the large exposures to housing mortgages (given the conjunction of high household debt levels and rapid house price rises until recently), and the continuing exposure of the pensions sector to market risks.

The risk factors are mitigated by the generally strong financial system and effective financial policies so that, combined with the more favorable international environment, near-term vulnerabilities appear low overall. Nevertheless, such risks require continuous monitoring, and some important challenges of a more medium-term nature remain. The authorities are well aware of the challenges and indeed pending legislation will formalize the recent organizational restructuring of financial supervision and related activities, which has been designed with the complexities of the continuously evolving financial system very much in mind.

The main findings of the Netherlands FSAP can be summarized as follows:

- The FSAP analysis generally confirmed other findings that, though some types of borrowers are more vulnerable than others, banks' sizeable housing-related exposures overall are mitigated by: banks' relatively low average loan-to-value (LTV) ratios (even though high ratios have been quite common at the margin, for more recent borrowers); the fixed-rate nature of most mortgages; the government guarantee covering around a quarter of mortgages; historically low mortgage default rates, even in the last housing market crash; and the recent deceleration of housing price rises to moderate levels.

- Domestic corporate exposures also appear manageable, despite rising debt levels and an increase in bankruptcies, in part because of the relatively significant fixed rate element of these loans.

- While cross-border exposures of Dutch banks have been an important source of growth and profitability in recent periods, exposure to adverse developments in key countries is significant and has been increasing. FSAP stress test indicated that a scenario of global slowdown associated with sharp U.S. dollar declines would have the greatest impact on banks' credit portfolio.

- Nevertheless, the stress testing indicated that the banking system could still absorb substantial shocks including the above without significant problems, given banks' strong capital and asset quality, generally good profitability, diversification and good risk management processes. Profitability of domestic operations, and associated inflexibility of cost structures, is something banks will need to continue to address as consolidation continues internationally.

- The insurance and especially pensions sectors have been under strain in the last couple of years, and are now in a rebuilding stage. They remain exposed to equity price risk, although the authorities took firm action with pension funds to restore solvency buffers over time, as part of a significantly upgraded supervisory regime. Linkages between the pensions and insurance sectors, and the banking sector appear manageable.

- The Netherlands enjoys a high standard of financial supervision, dealing effectively to date with the challenges associated with the LCFIs, including close cooperation and coordination with European and other foreign supervisors. The new supervision law will close a few, more technical gaps in specific areas.

- The new cross-sectoral organization structure for supervision that will also be reflected in the law aims to sharpen supervisory objectives, accountability and incentives, to ensure continued effectiveness and efficiency as the financial sector evolves. Continued work, both domestically and in an international context, will be needed in the crisis management area, as well as in further developing macroprudential surveillance.

- Over the medium term, the government should review the nature of its involvement in support of housing finance, especially with a view to phasing out the (reduced but still-extensive) tax deductibility of mortgage interest. This likely promotes over-borrowing and may add to the amplitude of housing cycles.

Box 1 summarizes the main recommendations stemming from this assessment. More technical recommendations are discussed in the main body of this report and in the standards assessments. Many of these are expected to be addressed when the new supervision law is finalized.

Box 1. Netherlands: Main Priority Recommendations

Financial Sector Supervision

- In the new supervisory legislation, clearly tie the Minister's final approval for ownership changes in the largest banks and insurers to the objective of maintaining financial system stability; and ensure that the process is fully transparent.

- Likewise, to clarify the budget approval process for supervisory activities, set down clearly in the new law the limited nature of the Ministry's role and the grounds on which such approval can be withheld. Consider the possibility of more explicit multi-year budgeting for the supervisors.

- Ensure that AFM is able to cooperate fully with foreign securities supervisors, even when there is no "domestic interest".

- Ensure the new supervisory regime for pension funds allows sufficient flexibility in the specified timeframe for making up shortfalls in the minimum solvency ratio, but without prolonging adjustment; e.g., legislation should clarify that 15 years is the maximum adjustment period.

Securities Settlement

- Work with relevant counterparts to increase the clarity and fairness of Euroclear access rules and to promote use of delivery versus payments arrangements (DVP) between Euroclear and foreign central securities depositories (CSDs).

Deposit Insurance/Crisis Management

- Give priority to completing the review of the deposit guarantee system, based on both Europe-wide and specific Dutch circumstances; consider the possibility of a scheme that is pre-funded to some degree at least, with risk-based premia.

- Continue working closely with other supervisors internationally on crisis management preparedness (especially for LCFIs) and extend current procedures documentation, as needed, to ensure effectiveness and clarity of key steps.

- Ensure that the use of a "silent receiver" for a listed institution does not cause an inconsistency with governance-related, listing or contractual requirements, and adjust contingency plans if required.

Macroprudential surveillance

- Continue to develop macroprudential surveillance processes and outputs; collect and disseminate additional or more timely indicators where needed (e.g., insurance and pensions data), within the overall objective of minimizing unnecessary administrative costs for supervised institutions.

Housing Finance

- Review the stability implications of fiscal or quasi-fiscal support for housing finance, especially with a view to phasing out the tax deductibility of mortgage interest. Consider eliminating or at least charging for the mortgage guarantee scheme.

I. Sources of Potential Risk

1. **The dominance of a small number of internationally active LCFIs, and the very open nature of the Netherlands economy, mean that international economic and financial developments are particularly important as potential risk factors**. Mortgage lending for banks, and equity market exposures for the large pensions sector, are important domestically. Key linkages and the main features of the system are illustrated in Figures 1 and 2.[1]

A. Macroeconomic Environment

2. **The macroeconomic environment, internationally and to a lesser extent domestically, is becoming generally more benign for the financial sector.** The local economy is expected to recover gradually in 2004 and into 2005, following poor performance over the past three years. For this year, growth is forecasted to reach about 1 percent, mainly owing to the upsurge in international trade, while domestic demand is expected to remain weak and unemployment is likely to continue its upward trend.

3. **Although uncertainties about macroeconomic prospects have receded, downside risks remain a concern.** Aside from the general risks surrounding the global economic outlook, specific downward risks, that could directly or indirectly impact on the financial sector, include further appreciation of the euro and a sharp correction of property prices, especially if in tandem with faster than expected interest rate increases globally. Even though the euro has appreciated more than 30 percent vis-à-vis the U.S. dollar since its trough in 2001, it remains below the imputed levels of the mid 1990s. A further rise would not be inconsistent with past volatility, and would have a strong impact on the Dutch economy (Table 1).

4. **While house prices appear to have made a "soft landing" during the downturn, a sharper decline could have a substantial impact.** Between 1997 and 2002, average real house prices rose by more than 50 percent, reaching historically high levels and reducing housing affordability (Figure 3). Since then, however, real price increases have slowed substantially and the average time to sell a house increased. While price levels are supported by shortages in housing supply, if a downward correction were to occur—as it did in the early 1980s—it would likely have a substantial effect on the domestic economy.

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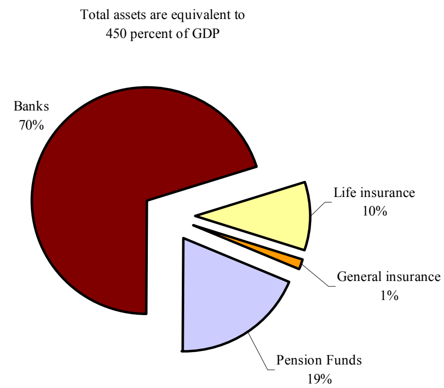
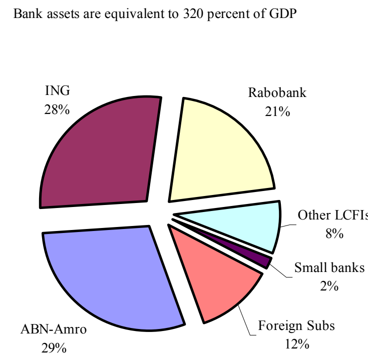
[1] Total pension fund assets are high by international standards and reflect a well-developed second pension pillar. The ABP civil servant pension fund, for example, is one of the largest in the world in assets €150 billion in 2003.

Figure 1. Netherlands: Features of the Dutch Financial System, 2003 1/

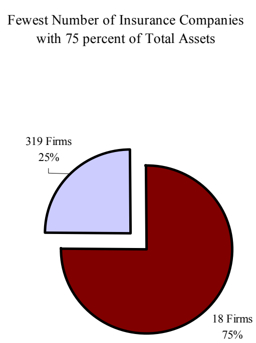
Banks form the core of the financial system...

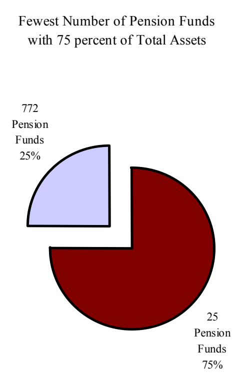


...with a few large players dominating the sector



The insurance and pension fund sectors are also concentrated





Dutch financial institutions have major foreign operations

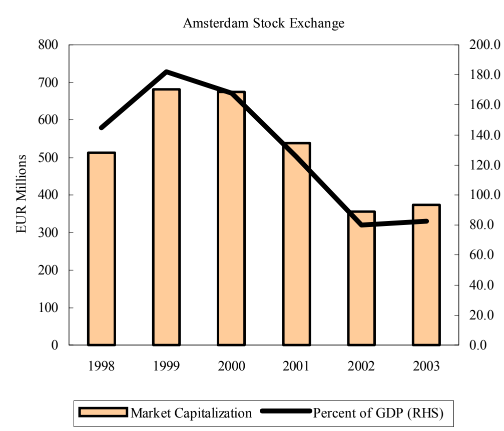
	Countries with major operations
ABN Amro	Americas (Brazil, US), Europe, Asia
ING Group	Europe (Belgium, Germany, Poland), Canada, US, Asia
Rabobank	Europe, Americas, Australia, New Zealand
Fortis	Belgium, Luxembourg, rest of Europe
Achmea	Belgium and Luxembourg
Aegon	Europe, Canada, US

Dutch financial institutions are highly rated

Credit ratings for key financial institutions

	Fitch	S&P
ABN Amro	AA-	AA-
ING Group	AA-	AA-
Rabobank	AA+	AAA
Fortis	AA-	AA-
Achmea	...	BBB+
Aegon	AA+	A+

Market capitalization of the Amsterdam Stock Exchange, which merged in Euronext in 2000, is about 80 percent of GDP

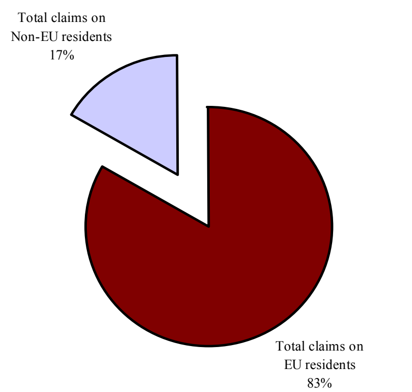


Source: Bankers Almanac, Bloomberg, DNB

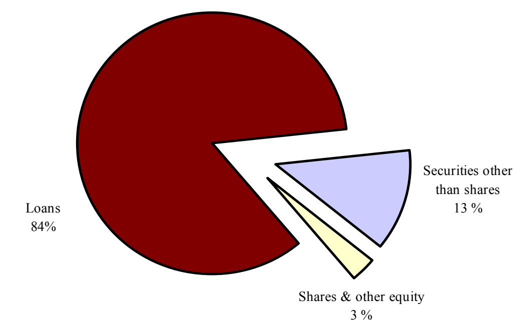
1/ Based on monetary survey data.

Figure 2. Netherlands: Major Exposures of Financial Institutions in the Netherlands, 2003 1/

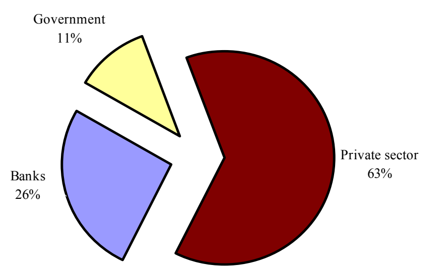
Over 80 percent of claims are on EU residents…



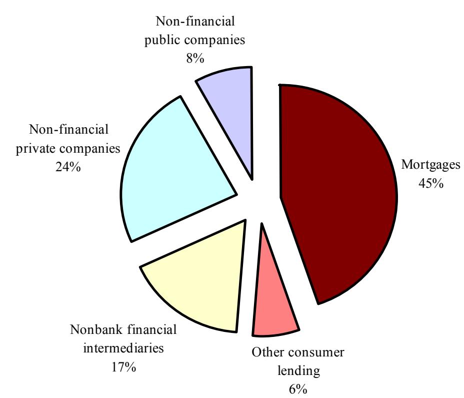
…most in the form of loans



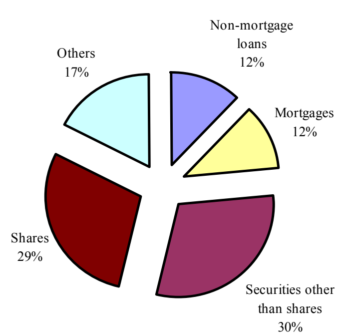
The bulk of the claims are on the private sector…



…with close to half of nonbank private sector lending in the form of mortgages

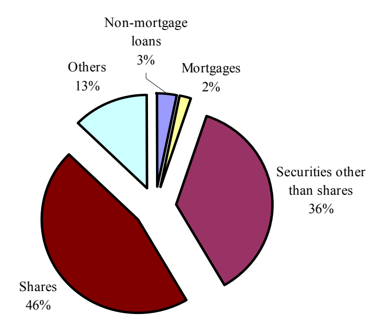


While insurance companies and pension funds…



Insurance Companies' Assets

…have relatively large equity exposures

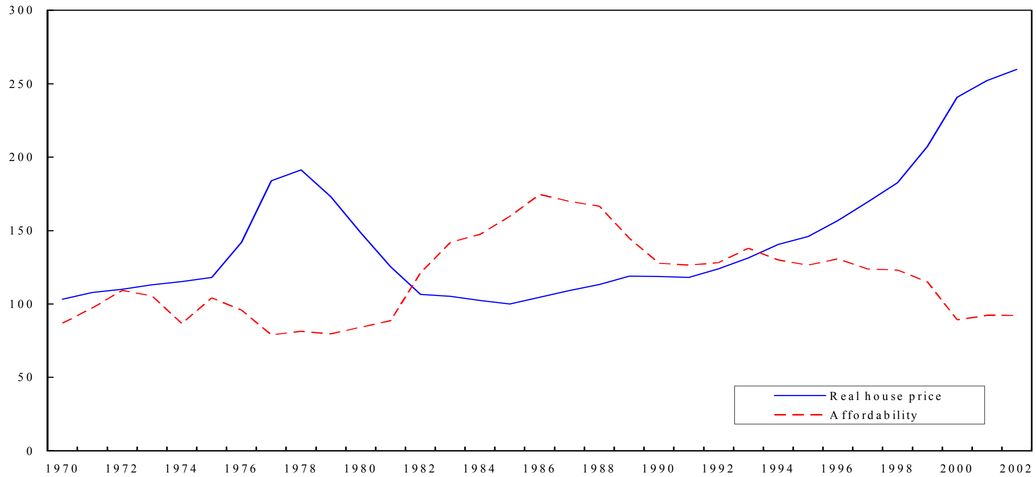


Pension Funds' Assets

Source: DNB

1/ Based on monetary survey data.

Figure 3. Netherlands: Real House Price and Affordability



Source: BIS and Rabobank

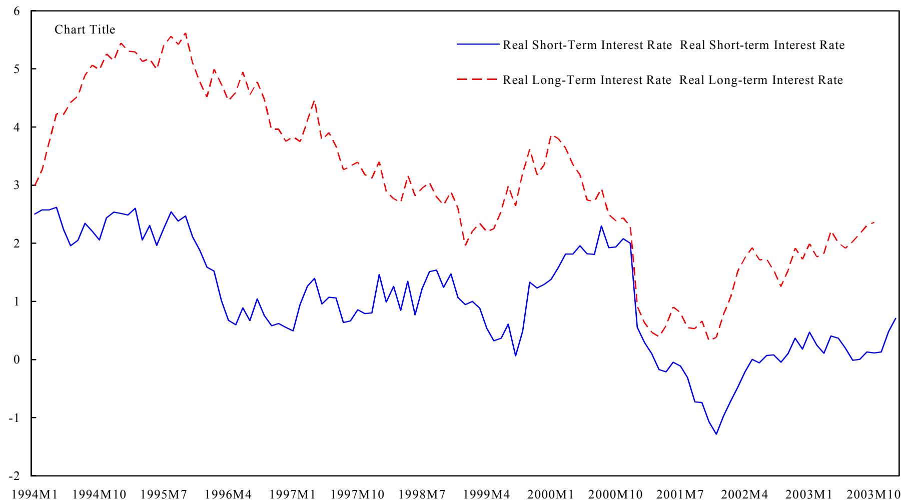
Table 1. Netherlands: Historical Volatility of Key Variables (1977–2002)
(in percent)

	Standard Deviation	Largest Annual Increase	Largest Annual Decrease
House Prices	9	38	18
Equity prices (World)	15	37	34
Equity prices (Netherlands)	18	50	42
Euro/Dollar	13	31	33
Bond yield (percentage points)	1.1	2.2	3.2

Source: DNB

5. **Substantial further increases in real interest rates would also pose a risk to the recovery, not only by affecting investment and consumption decisions at the margin, but also through its potentially destabilizing effect on the housing market.** Real interest rates have been on the rise since early 2002, but remain low by historical standards (Figure 4). But if faster than currently expected rises occur in longer rates globally, while domestic unemployment continues to trend up, the mix could be problematic given high household and corporate debt levels.

Figure 4. Netherlands: Real Interest Rates



Source: IFS

B. Major Counterparties

Household sector

6. **Household debt levels have grown rapidly in recent years and could pose a risk if interest rates or unemployment were to rise sharply (more so in combination); or if there were large declines in housing and equity prices** (Figure 5). Mainly reflecting mortgage lending growth, the household debt to GDP ratio for the Netherlands has grown to over 100 percent of GDP in 2002 and although the same trend is seen in many other EU countries, the level in the Netherlands is considerably higher than the EU average of about 50 percent.[2] Several factors seem to have supported the rapid growth in mortgages, not least extensive tax deductibility of interest, as well as a government guarantee of a significant number of mortgages (Box 2). Over the last couple of years, the authorities have moved to narrow the scope of interest deductibility, and this probably contributed somewhat to the recent slowdown in mortgage lending and house prices.

7. **There are several factors mitigating those risks, especially the fact that mortgage rates are usually fixed for relatively long periods in the Netherlands**. Hence, in the short term at least, it is more likely to be only certain groups of borrowers that would be heavily affected by rate rises. More broadly, households seem to have weathered the economic slowdown relatively well overall, and the debt service ratio has fallen somewhat recently; nevertheless, unemployment and personal bankruptcies trends have both been rising over the last four years, and some further increase is likely before the situation improves.

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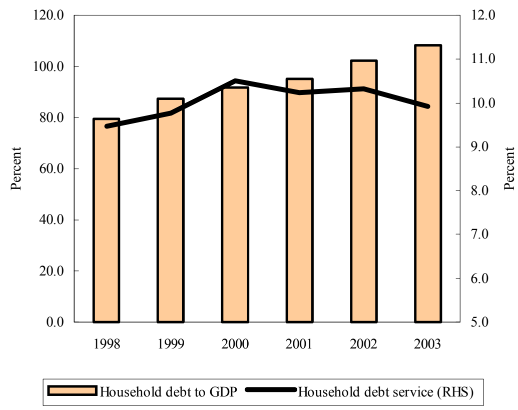
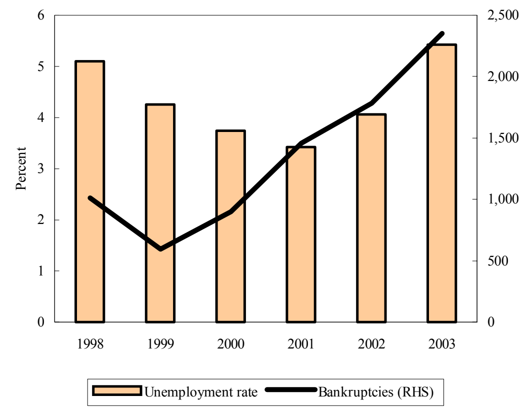
[2] Household assets and net worth are reportedly also quite high by international standards, though this partly reflects the effect of housing prices.

Figure 5. Netherlands: The Household and Corporate Sectors

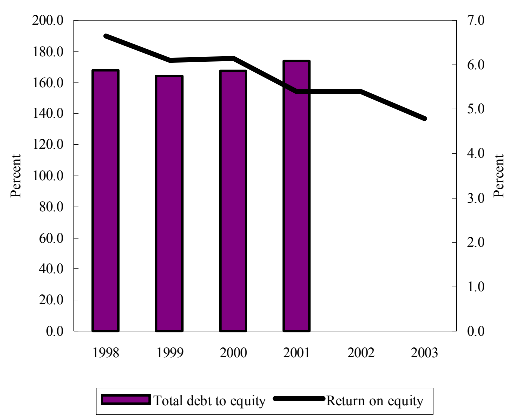
Household debt is growing, although debt service is near constant…



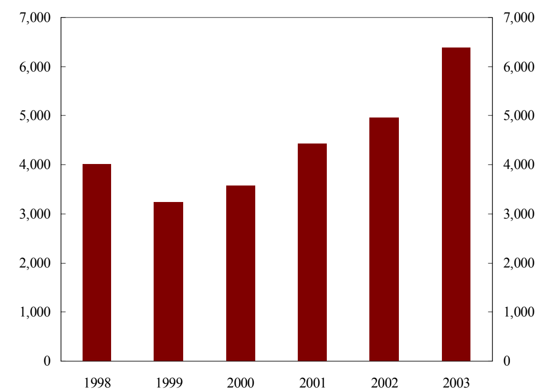
...but bankruptcies have increased in tandem with unemployment



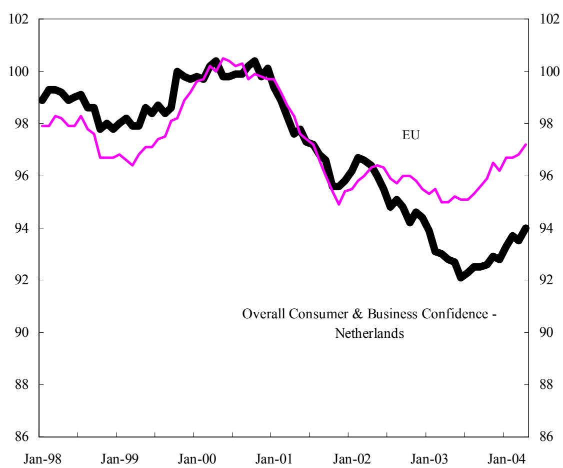
Corporate debt has not increased as much as household debt…



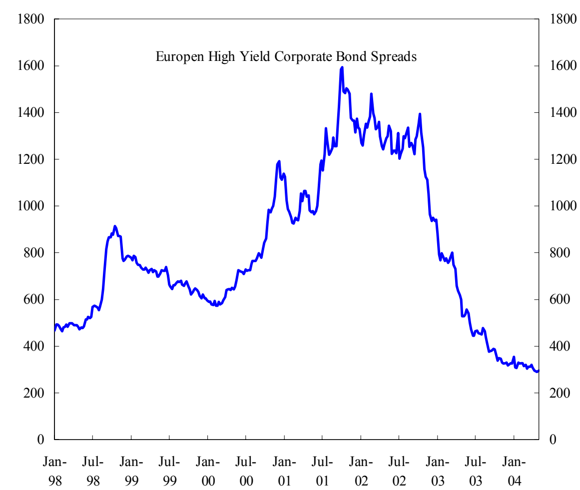
…although bankruptcies also increased in line with economic conditions



With improving economic conditions, confidence has returned…



…and corporate bond spreads have declined



Source: Bloomberg, CBS, Datastream, DNB

Box 2. Netherlands: Mortgages in the Netherlands

Over the past decade the amount of mortgage debt in the Netherlands has roughly doubled as a share of GDP. At the same time, it has become common to finance all expenses related to the home purchase, including transaction costs, through the mortgage loan. Consequently, LTV-ratios for new loans have risen sharply, reaching 108 percent on average in 2003 (excluding refinancing and second mortgages). Dutch mortgage loans typically have a maturity of 30 years and interest rates are normally fixed for considerable periods of time (mostly 5 or 10 years). Around one quarter of mortgages is covered by a government sponsored 'national mortgage guarantee plan' that basically eliminates the default risk for the lender and allows the borrower to secure a lower borrowing cost.

Tax deductibility of mortgage interest payments has contributed to recent increases in property prices and, in particular, to the simultaneous expansion and increasing complexity of the mortgage market. The tax deductibility encourages purely tax-driven financing choices and provide a disincentive for principal repayments prior to maturity. Therefore, financing arrangements that keep debt and interest payments at the maximum level during the life time of the loan have become increasingly popular. A recent survey by the Nederlandsche Bank shows that only about 8 percent of total mortgage debt outstanding is financed through traditional linear or annuity loans—and that percentage is considerably lower for new loans.

Netherlands: Mortgage schemes (2003)
Percent of total

	Total debt outstanding	New mortgages
Linear or level repayment	8	4
Interest only	42	35
Savings-linked	30	13
Investment-linked	19	48

Source: DNB

The vast majority of mortgages entail schemes that either require only the payment of interest—an option available for loans up to a certain LTV threshold—or that are linked to some form of savings or investment accounts. In the latter cases, monthly principal payments are accrued in a separate account which is used to clear the mortgage at maturity. During the life time of the loan, the accrued principal payments are used to generate interest income (savings-linked mortgages) or invested in pre-specified risk bearing assets (investment-linked mortgages).

In the case of savings-linked schemes, full clearance of the loan at maturity is secured by design, but this is uncertain for investment-linked mortgages, where the accumulated sum depends on actual investment returns. Investment-linked mortgages thus involve the basic risk of a residual debt at maturity if portfolio returns fall short of the assumed rate underlying the design of the loan.

Risks are further increased as mortgagors accept higher risks and leverage their positions. Since it is typically assumed that the investment returns will be higher than the mortgage interest paid, thus reducing the estimated monthly costs, investment-linked loans increase the borrowing capacity of the mortgagors. Indeed, the higher the investment risk borrower and lender are willing to accept, the larger is the borrowing capacity. According to the same principle, reportedly, borrowing capacity of individuals is sometimes raised by allowing mortgagors to invest capital gains on the previous owned home—rather than using them as a down payment—in order to generate a flow of income which is used to offset part of the monthly payments. Even more risky schemes involve the lease of shares in order to generate higher returns, but it is unclear how wide-spread such arrangements are.

Mitigating short term risks associated with investment-linked schemes is the fact that shortfalls with respect to the principal only materialize at maturity or when the loan is prematurely terminated. Generally, investment-linked mortgages do not involve contractual obligations to make additional interim payments when investment returns stay behind expected levels.

Corporate sector

8. **High corporate indebtedness in the Netherlands also poses a risk if interest rates were to rise unexpectedly and rapidly; but the risk is mitigated, as for mortgages, by a relatively high proportion of business loans that are at fixed rates for longer periods.**[3] Corporate indebtedness initially increased despite pressures on many firms to improve profitability and reduce leverage, but lending to corporates has slowed right down in 2002, as the recession took hold and bankruptcies increased. Commercial real estate has been quite depressed throughout.

9. **Low interest rates and improving prospects for an economic recovery have encouraged firms to issue new debt in capital markets in 2003, and bank lending also began picking up again from the second half of the year**. The tendency toward longer-term loans is continuing in this environment. Efforts made by firms to improve profitability are beginning to show fruit but the success of restructuring efforts depend importantly on continued growth. Still, market indicators of risks—corporate bond spreads, corporate bond defaults, ratings trends—seem to point to recovery and reduced risk in this sector. The outlook for SMEs, however, is less positive than for larger companies, as they are more linked to the local economy.

10. **Following several high profile scandals in recent years, important corporate governance reforms are occurring in the Netherlands: these are likely to reduce the potential for reputational risk for Dutch corporates and financial institutions in times of stress, and improve responses to strategic challenges**. Previously, Dutch corporate governance had the reputation of being rather weak compared with other industrial countries, due to the frequent use of anti-takeover devices and management-oriented organizational structures. A new corporate governance code based on the recommendations of the "Tabaksblat Committee" came into legal force, on a "comply or explain" basis, at the beginning of 2004, and major Dutch companies have already started to comply with it.

International exposures

11. **Dutch institutions are significantly exposed to external developments and risks through both related entities and investments, and direct cross border exposures** (Figure 6). For example, the importance of banks' foreign subsidiaries is reflected in their substantial contribution to overall profitability. Meanwhile, insurance companies and pension funds hold significant amounts of foreign securities directly—total Dutch holdings of such securities was equivalent to 120 percent of GDP in 2002. Furthermore, the system's significant direct and indirect exposures to the stock market are another important transmission channel for external financial and economic developments.

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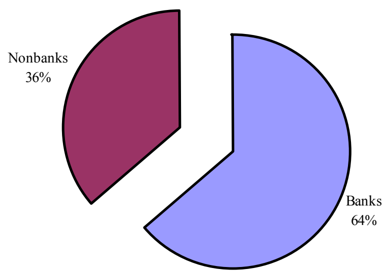
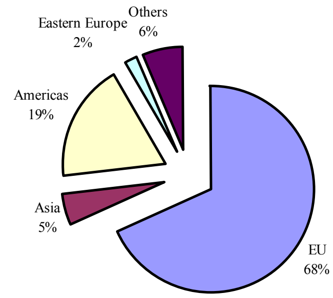
[3] See Figure 5 for debt ratios and Table 16 in Appendix II for debt levels. It is reported that some two-third of Dutch bank loans to firms have rates fixed for five or more years. Banks hedge themselves against the consequent interest risks primarily through interest rate swaps. They also securitize and sell mortgages. Ultimately, the risk is borne by an array of domestic and foreign investors.

Figure 6. Netherlands: International Exposures of Financial Institutions in the Netherlands, 2003

Cross-border claims are mostly on banks…

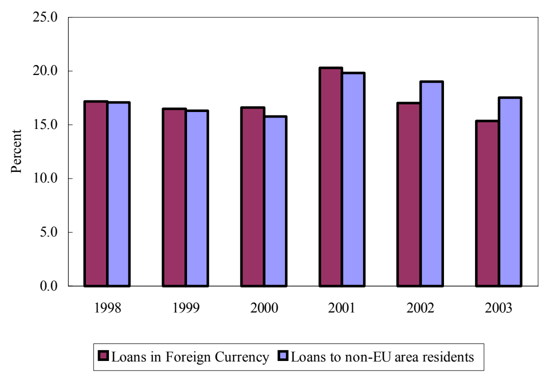


…who are mainly in the EU



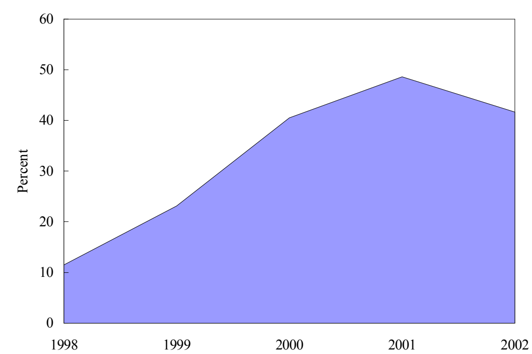
One-fifth of loans are to Non-EU residents

Loans to Non-EU Residents and Loans in Foreign Currency
(percent of total loans)



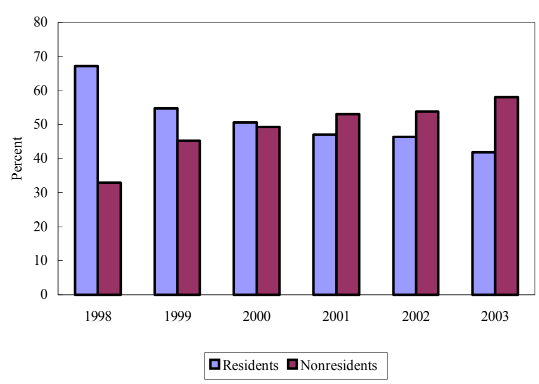
Foreign operations are a significant source of profits

Dutch Banks: Non-Dutch Contribution to Profits



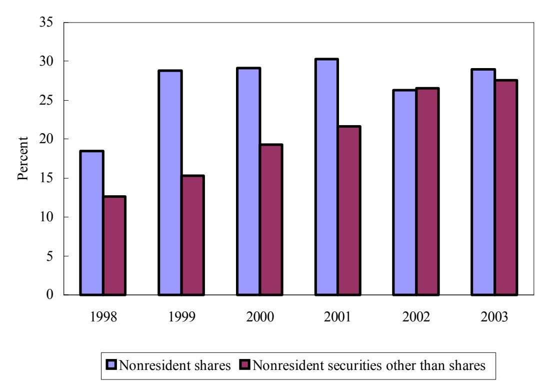
Insurance companies and pension funds have seen growing international exposures…

Insurance Companies' and Pension Funds' Assets by Residency



…with most in equities and other securities

Share of International Equities and Other Securities



Source: DNB

12. **Dutch banks have been steadily increasing their cross-border exposures especially to Western Europe which now account for about two-third of external claims.** At the same time, reflecting an environment of greater uncertainty, exposures to emerging markets have declined substantially, while even within Europe, Dutch banks have preferred borrowers with lower credit risk such as the public sector and European banks subject to supervision. While Dutch banks generally had exposures to a wide range of countries, exposures to the United Kingdom, Germany, and the United States each comprised more than 10 percent of total external claims over the period. With respect to the LCFIs foreign subsidiaries and associates, a similar general pattern of exposures (emphasizing industrial countries rather than emerging markets) also applies.

13. **With global economic recovery strengthening and broadening, risks associated with Dutch institutions' international exposures have declined**. Global growth is expected to be broad based although most rapid in emerging Asia and the United States, with Europe lagging. Nevertheless significant short and longer-term challenges remain including geopolitical risks, higher oil prices, and managing the transition to higher interest rates, as well as large U.S. current account deficits and surpluses elsewhere.

II. Strengths and Vulnerabilities: Institutions and Markets

A. Banks

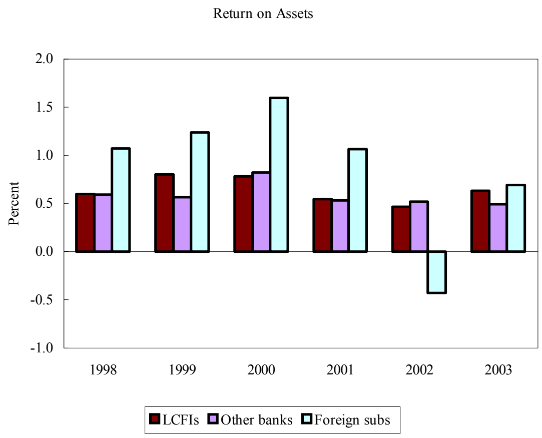
14. **Banks in the Netherlands have performed reasonably well over the last five years with return on equity in the range of 10–20 percent for the three largest LCFIs**. (Figure 7 and Table 2). In 2003, despite the weak domestic economy and the depreciation of the U.S. dollar, their operating profits rose by more than 40 percent, reflecting on the one hand a rise in interest income, and on the other hand falling corporate costs and declining provisions. For the smaller Dutch banks return on equity (assets) was 12.6 (0.5) percent in 2003. Prospects in the short-term have turned positive in line with expectations for a recovery, and the markets' positive view for the main banking groups is evidenced by increasing share prices in 2003 and early 2004 (Figure 8).

15. **In comparison with international peers, however, Dutch LCFIs' operational efficiency—at least on the usual measures such as return on assets, and cost to income ratios—is below average** (Figure 9). [4] In part this reflects lower interest margins, but nevertheless, Dutch LFCIs have been making efforts to reduce costs, including restructuring operations. More may need to be done here, especially as financial conglomeration and integration continues internationally.

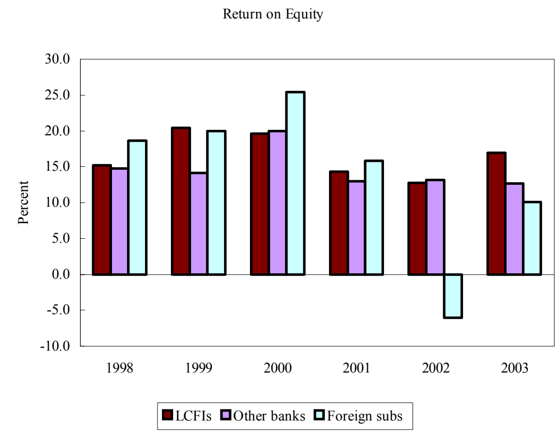
[4] Several reasons may be behind this poorer relative performance despite the concentrated domestic market. These include: (i) the presence of a large cooperative bank; (ii) relatively less flexible cost structures (labor, in particular); and (iii) in the past at least, less pressure to maximize shareholder value.

Figure 7. Netherlands: Banks' Performance, 1998–2003

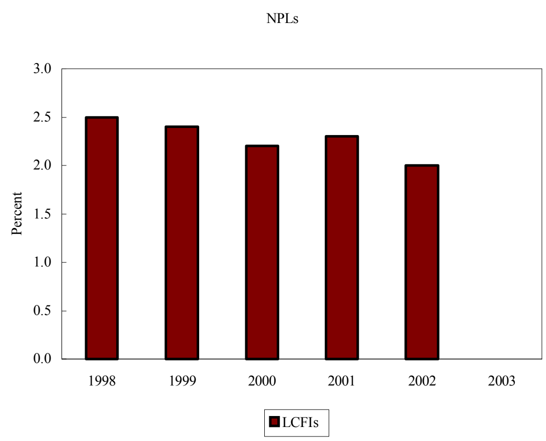
Banks have weathered the economic slowdown…



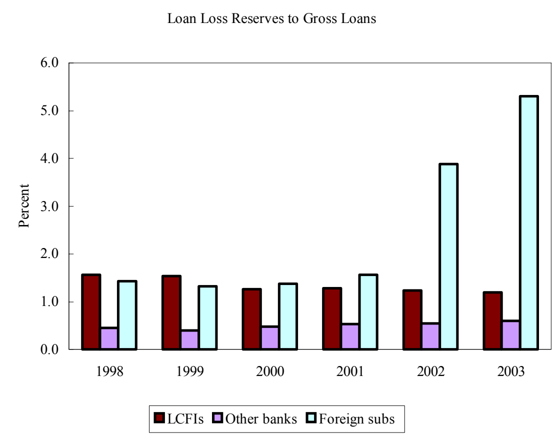
…with ROE for LCFIs above 16 percent



Quality of banks' assets have been good despite economic conditions although…

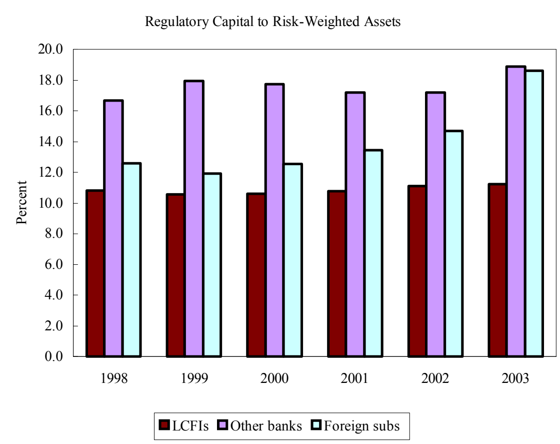


…smaller banks have had to increase provisions reflecting their riskier portfolios



Banks appear to have ample liquidity…

…and are well capitalized



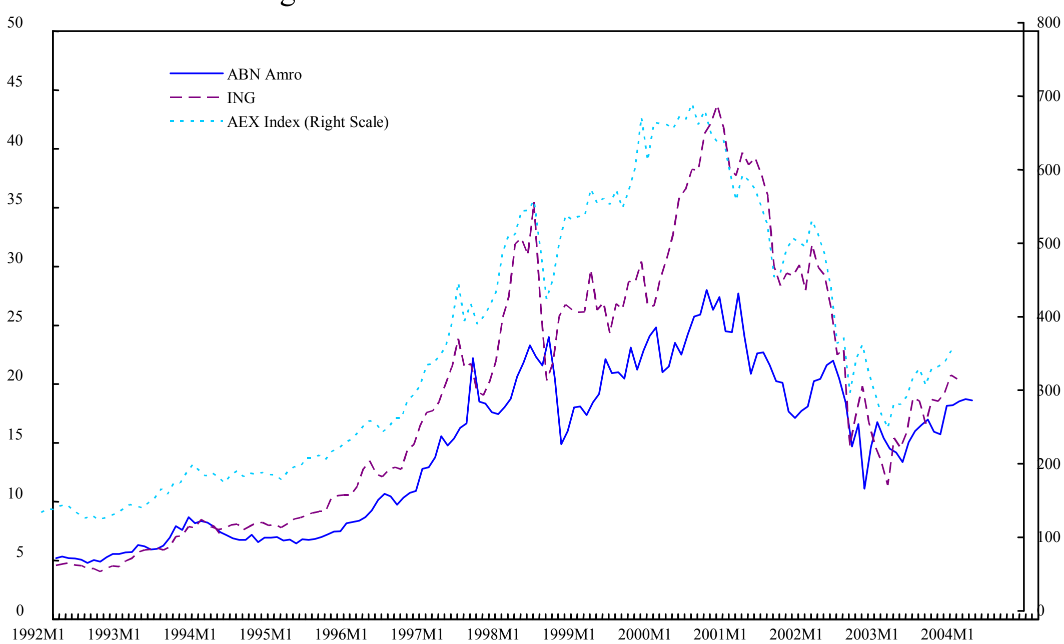
Source: DNB

Table 2. Netherlands: Performance of Dutch Banks
Percent changes over previous period

	1999	2000	2001	2002	2003
Total Income	20.3	17.8	-0.6	-1.1	3.5
Interest	15.7	6.3	6.5	7.2	4.0
Commissions	24.6	28.8	-11.2	-7.3	-5.0
Total Expenses	11.9	17.2	7.2	2.4	-4.8
Corporate costs	15.5	19.8	2.1	-2.2	-0.8
Provisions 1/	-18.4	-14.2	94.0	43.9	-29.3
Operating profits 1/	51.7	19.5	-21.9	-14.5	40.9

Source: DNB
1/ Includes asset revaluations.
2/ Before tax.

Figure 8. Netherlands: Selected Share Prices



Source: Bloomberg.

16. **Dutch banks are well-capitalized, and their asset quality has been good despite weak economic conditions.** Regulatory capital ratios for the LCFIs have increased from 10.8 percent in 1998 to about 11.2 percent in 2003, while those for smaller banks and foreign subsidiaries are higher and also increased last year. Non-performing loans (NPLs) have hovered around 2–3 percent of total loans for the LCFIs although loan loss provisions have more closely followed the economic cycle. Smaller banks and especially foreign subsidiaries have had to increase their provisioning more sharply reflecting riskier portfolios.

Figure 9. Netherlands: Dutch LCFIs in the International Context

Dutch LCFIs are among the largest financial institutions globally and compete well against their peers although measures of operational efficiency (ROA and cost to income ratios, for example) are worse than average

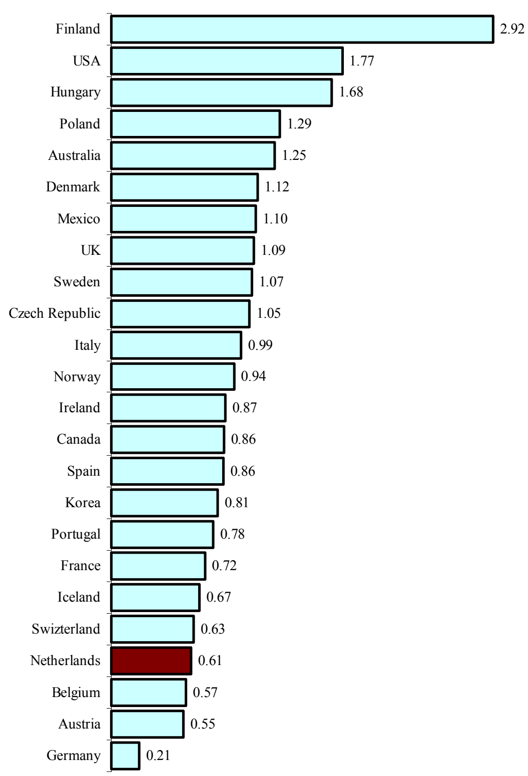
Banks	Total Capital Ratio	Net Interest Margin	Return on Average Equity (ROAE)	Return on Average Assets (ROAA)	Non-interest expense/ Average Assets	Cost to Average Assets (Cost Margin)	Impaired Loans/Gross Loans 1/
ABN Amro Holding	11.7	1.9	20.2	0.6	68.0	2.5	2.0
ING Bank	11.3	1.7	9.9	0.3	74.9	1.8	1.8
Rabobank Netherlands	10.9	1.6	7.5	0.4	71.8	1.8	n.a
Average	11.3	1.7	12.6	0.5	71.6	2.0	1.9
Peer Group 2/	12.2	2.0	12.7	0.8	66.2	2.6	2.9
			Percentile ranking vis-à-vis peer group				
ABN Amro Holding	17%	53%	90%	43%	53%	48%	37%
ING Bank	8%	46%	24%	22%	78%	17%	34%
Rabobank Netherlands	3%	46%	22%	25%	71%	14%	n.a

Source: Bankscope

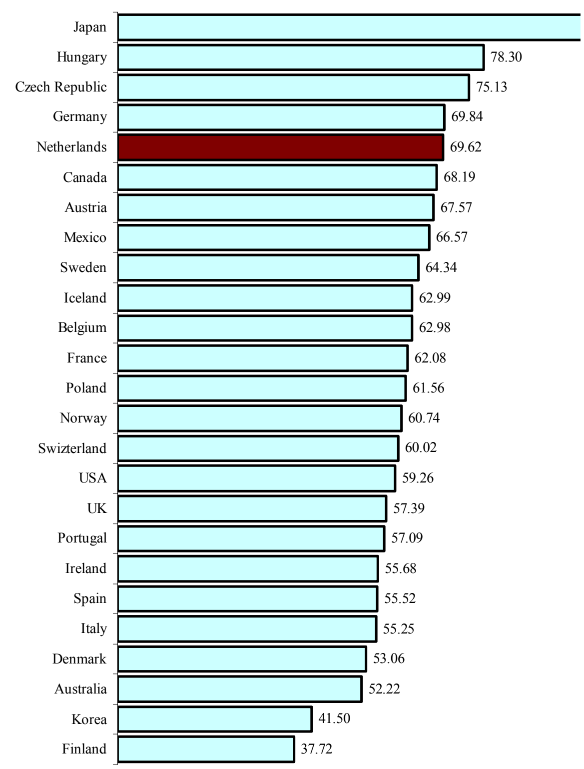
1/ Based on 2002 financial statements.

2/ Sample of large North American and European Banks - Bank of America, Barclays, BNP Paribas, Citigroup, Commzerbank, Credit Agricole, Credit Lyonnias, Credit Suisse, Deutche Bank, HSBC, JP Morgan Chase, Lloyds TSB, Royal Bank of Canda, Royal Bank of Scotland, UBS, Wachovia

Return on assets are among the lowest in the OECD…



…while the cost to income ratio is among the highest



Source: OECD, Based on 2001 data.

17. **The quality of banks' portfolios reflects several factors.** First is banks own generally good risk management capacity and processes which ensure that risks are appropriately managed and controlled. Second, banks' substantial foreign operations have been an important source of portfolio diversification that has helped minimize risks associated with concentration in one particular sector or geographical region. Finally, exposures to mortgages have so far been relatively safe, overall.

18. **While mortgages form the largest single share of banks' portfolio, risks to banks from these loans are mitigated by several factors.** In addition to the factors mentioned in Section IB: (i) there has been a tradition of good payment discipline amongst Dutch households, and default rates for mortgages remain low—indeed, they were low even during the last crisis; and (ii) mortgages are secured borrowing, and the average loan-to-value (LTV) ratio for the stock of mortgages remains relatively low around 50 percent overall—even if LTV ratios on newer mortgages are on average high.

19. **Therefore, the mortgage-related risks are more relevant for specific recent borrowers—such as those that rely on two incomes to finance their mortgage, or those that have taken investment-linked or leveraged mortgages; risks are also more concentrated in some smaller banks or foreign institutions that have been particularly active in trying to build market share.** Recent borrowers may be riskier if unemployment increases or the performance linked-investment returns are below expectations, but not necessarily in respect to interest rate rises.[5] Recent tax changes should help limit the incentives for borrowing at higher LTVs, and it would be desirable to do more in this direction over time. More immediately, close supervisory attention is needed—and is being applied—to institutions that have been most active in extending high LTV mortgages, to ensure that appropriate loan classification and provisioning, for example, is occurring.

20. **Dutch LCFIs appear to have ample liquidity, as well as a moderate market risk appetite.** Liquid assets are able to cover 50 percent of short-term liabilities, a situation that has been maintained consistently since 1998. Market risk as measured by the three largest banks' value at risk seem manageable (about 150–200 million Euro for a 10-day horizon or about 0.4 percent of capital). The level of market risk taken by banks is consistent with the market view that Dutch banks take a moderately cautious view with regards to trading risk (Figures 10 and 11).

[5] More generally, there may also be broader indirect effects on financial institutions from the macroeconomic consequences of a housing market crash—i.e., if it shifted the economy back into recession.

Figure 10. Netherlands: Daily Var and Profit and Loss at the 3 Largest LCFIs

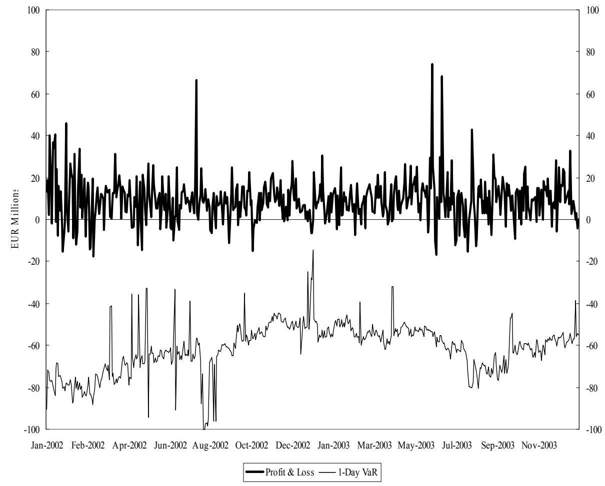
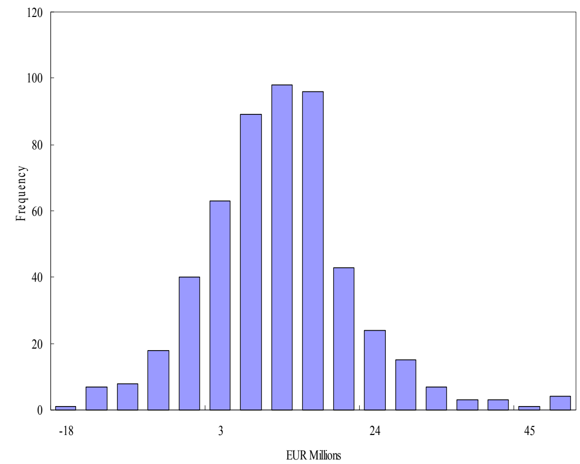


Figure 11. Netherlands: Distribution of Profits from Trading Activities at the 3 Largest Banks



21. **The stress testing exercise conducted as part of the FSAP supports the view that banks exposure to credit risk is well-managed; that market risks are minimal;[6] and that liquidity or concentration risks are low** (see Box 3 and Appendix I). The greatest adverse impact on banks' credit portfolio would be a dollar decline/global slowdown scenario, reflecting banks' cross-border exposures and more generally, linkages between the Dutch and global economy. Conversely, potential losses from a purely domestic shock is mitigated by banks' global exposure. Losses from mortgages under both scenarios are minimal. In addition, a recent examination of the liquidity profile of reporting banks by the DNB confirms that most banks have sufficient liquidity: no bank had liquidity shortages based on a weekly test, while two banks had a shortage in the monthly test. These banks, however, are branches of foreign banks and have support from their head offices.

B. Insurance and Pension Funds

22. **The performance of insurance companies has been more mixed, mirroring the performance of equity markets to which these companies have been exposed**. In particular, Dutch insurers (as elsewhere) have suffered from declining share prices and low interest rates, as well as sharply rising reinsurance costs after the attacks of September 11, 2001.[7] There has been a strain on insurance company profits, while asset values and solvency margins have declined (Figure 12). However, the industry and government have developed an arrangement to limit future insurance losses arising from acts of terrorism in the Netherlands, while asset values and solvency margins have improved somewhat in 2003 given the recovery in equities markets. Nevertheless, overall performance is likely to be still rather weak.

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[6] Interest rate risk, for example, is well hedged.

[7] The three largest groups of insurance companies generate 80 percent of their income abroad.

Box 3. Results of Main Stress Tests

Banks

- Banks' sensitivity to market risk is small reflecting the importance of banking vis-à-vis trading activities. The most adverse shock is an upward shift in the interest rate yield curve, but even such a shock does not have an appreciable impact on banks' CAR.

- Banks are able to withstand the two scenarios designed to test the system's sensitivity to domestic and external macroeconomic shocks. In the most extreme scenario, banks' CAR declines from 11.1 to 10.5 percent, on average, while the CAR ratios for individual banks remain well above 8 percent.

- In addition to these shocks additional assessments of liquidity, concentration, and contagion risk were carried using supervisory data collected by the DNB. Based on these data, liquidity and concentration risks appear to be limited.

- The assessment of interbank contagion risk confirms the importance of large banks but underscores the global nature of bank exposures: the failure of a large Dutch bank puts pressure on other Dutch banks but does not lead to failure of another large Dutch bank because these banks have most of their exposures with other foreign banks. Conversely, losses from abroad, if they occur simultaneously, would have a negative impact on Dutch banks.

Impact of Stress Tests on Banks' CAR

Shocks and Scenarios		Change in CAR
Interest rate	+100 bps	0.0
	- 100 bps	0.2
	50bps steepening	0.1
	50 bps flattening	0.0
	+ 25% in volatility	0.1
Exchange rate	+10%	0.1
	- 10%	0.0
	+ 25% in volatility	0.0
Equity	+10%	0.1
	- 10%	0.0
	+ 25% in volatility	0.1
Credit spreads	+50 bps	0.0
	- 50 bps	0.1
Domestic crisis	Over 1 year	-0.1
	Over 3 years	-0.4
Dollar crisis	Over 1 year	-0.3
	Over 3 years	-0.6

Impact of Stress Tests on Insurance Companies' and Pension Funds' Solvency Margin

Shocks and Scenarios	Insurance Companies' Change in Solvency Margin	Pension Funds' Change in Solvency Margin
Interest rate	-0.3	-3.6
Credit Risk	0.0	-0.7
Equity	-4.2	-15.2
Property	-1.6	-2.6
Commodity	0.0	-1.0
Currency	-0.5	-8.4
Technical insurance	-0.1	-1.3
Costs	-1.0	-0.1
Correlation = 0	-4.8	-18.7
Correlation = 0.5	-6.4	-26.8
Correlation = 1.0	-7.7	-26.7

Insurance companies and Pension Funds

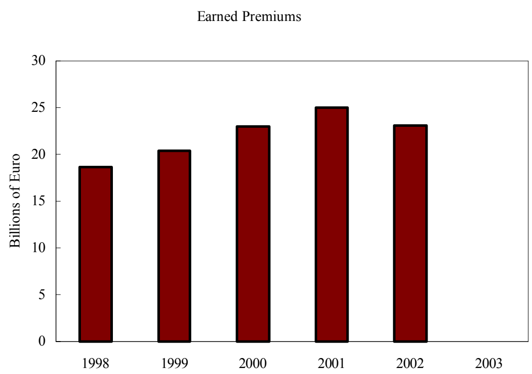
- Insurance companies are able to absorb most of the stress tests shocks and scenarios except for the most extreme scenario when the solvency margin, on average, declines to 99.2 percent from 106.9 percent. Reflecting their exposure to equity and property markets, insurance companies show greater sensitivity to declines in these prices.

- Pension funds' solvency ratios fall below 100 percent in nearly all the tests carried out. In the most extreme scenario the solvency margin, on average, declines to 76.4 percent from 103.1 percent. Pension funds are more sensitive to market risks because they hold a greater proportion of equity and are more internationally exposed compared to insurance companies. In addition, results are more volatile because of longer duration fixed income assets that are marked to market.

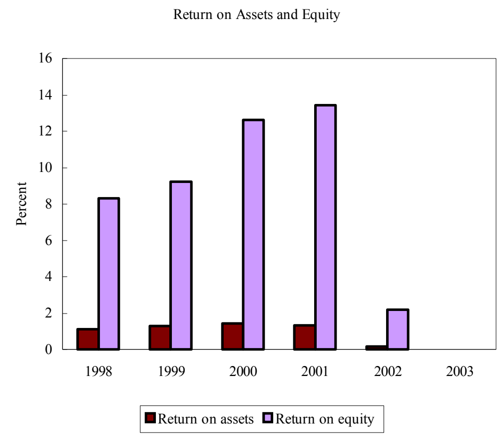
- The results for insurance companies and pension funds are based on conditions at end-2002 and exclude the effect of remedial measures required by the PVK. Moreover, equity markets have improved since then.

Figure 12. Netherlands: Insurance Companies' and Pension Funds' Performance, 1998–2003

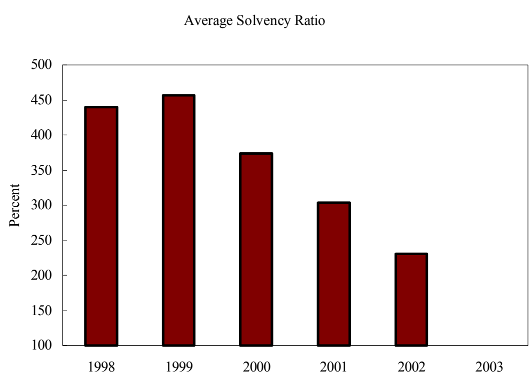
Life insurers' earned premiums declined during the slowdown...



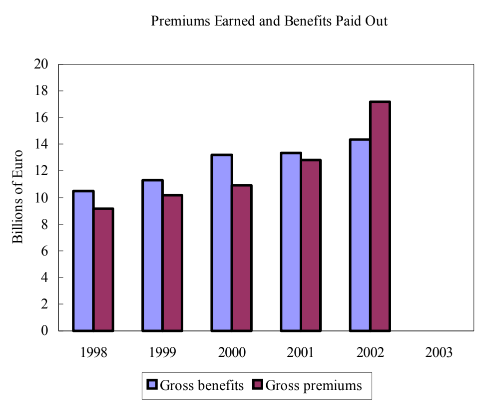
... together with investment losses resulting in poor results…



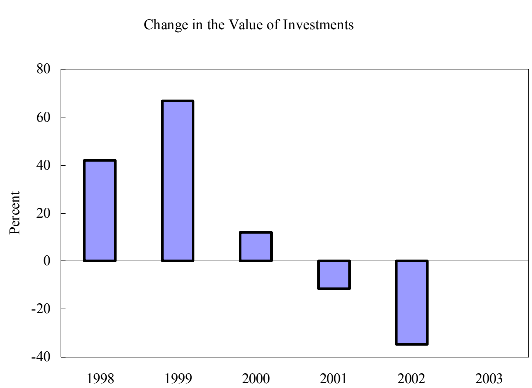
…and so solvency margins continued to decline.



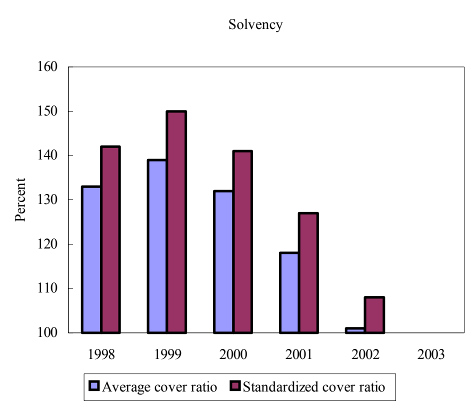
Pension funds remain fairly liquid…



Although large losses from equity portfolios…



…have resulted in a steep fall in solvency margins



Source: DNB, PvK

23. **Pension funds recorded substantial losses in 2000–02 causing coverage ratios[8] to plunge, mainly as a result of the fall of share prices in 2001–02**. This development prompted the PVK to tighten its supervision standards, requiring all pension funds to attain a coverage ratio of at least 105 percent by the end of 2003, and to form substantial additional buffers depending on the average risk of the portfolio, over a longer period. In 2003, with the recovery of the stock markets, and reflecting also the initial remedial actions taken (increasing contribution rates or lowering benefit payments, including reducing the effect of future indexation), pension funds were able to recoup some of their earlier losses. Average coverage ratios improved somewhat, and all the larger funds attained the 105 percent target.

24. **The stress tests underscore the continued sensitivity of insurance companies and especially pension funds to equity, interest rate, and currency risks, although the potential for spillover to the banking system seems moderate.** Insurance companies were able to absorb reasonably well all but the most extreme shock. In that case, their solvency margin declined to just under 100 percent. [9] But pension funds would see their solvency ratio fall below required levels in nearly all the tests. Serious problems in the pensions sector (and to a lesser extent insurance) have the potential to feed back to the banking sector through the markets in which such institutions are active, or, less directly, through the macro-economy. In the first case, however, the fact that the relevant markets are Europe-wide or global mitigates the risk, at least for Dutch-specific problems. In the second case, the strengthened supervisory arrangements take into account the need to avoid unduly sharp reactions by funds, that may have macro implications (e.g., through changes in contribution rates, or wealth and confidence factors).

C. Contagion Risks

25. **Large Dutch banks have most of their direct interbank exposures with foreign banks, so would be negatively impacted if losses on these exposures occur simultaneously. They are correspondingly less exposed to each other in the interbank market.** Domestic interbank contagion risk was assessed by the DNB under the stress testing exercise, and confirmed, unsurprisingly, that the failure of a major bank would put other banks under important strain. However, such an event does not cause other large banks to fail, in part because of the above reason.

26. **Dutch financial institutions are also exposed to one another via other channels such as cross share-holdings, common ownership (financial conglomerates), and risk transfer arrangements.** These exposures are potential channels for contagion but at the same time, reflect the diverse and international character of Dutch financial institutions. Cross-shareholdings tend to be interlinked, but at fairly moderate levels in general (Table 3).

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[8] The coverage ratio is defined as the value of the assets as a percentage of the pension liabilities.

[9] For insurance companies, the stress tests were not able to estimate the impact of interest rate risk as valuations are not marked-to-market.

Major banks also have large insurance operations and while in theory this would be a benefit from an interest rate risk perspective, such benefits are difficult to assess in practice. Moreover, banking and insurance activities within the same financial group may be exposed to similar sources of credit risk. Risk transfer arrangements such as credit derivatives are only beginning to be used in the Netherlands but provide another avenue for risk management—even as they create another channel for contagion risk.

Table 3. Netherlands: Cross-Ownership Among Financial Institutions, end-2002

Institution	Shares held in
ABN Amro	ING (6 percent)
Aegon	ABN Amro (9 percent); ING (6 percent)
Fortis	ABN Amro (6 percent); ING (6.5 percent); Kas Bank (6.5 percent)
ING	ABN Amro (7 percent); Kas Bank (6.5 percent)
Rabobank	ABN Amro (6 percent)

Source: AFM and DNB.

D. Availability and Use of Markets to Mitigate Risk

27. **The Dutch banks use Euro-area wide interbank, repo and forex markets for financing liquidity which has improved the depth and liquidity of funding instruments and eliminated currency risks within the Euro area.** Dutch banks also use currency swaps to finance liquidity in both foreign currencies and Euro, and this market tends to be more resilient than the interbank market in times of stress, as one leg of the currency works as collateral for the other.

28. **DNB provides liquidity, at its own initiative, on a fully collateralized basis, subject to close coordination with ECB.** In view of the substantial amounts of eligible collateral held by Netherlands financial institutions, DNB's standing facilities are expected to be able to meet liquidity needs in most circumstances.

29. **The role of the domestic securities market is relatively limited.** Nevertheless, the recent development of the securitization and other credit-risk-transfer markets will likely facilitate redistribution of credit risks from the banking sector to the rest of the financial system, and provide the insurance and pension sectors with better investment opportunities. Dutch government and corporate bond market are also integrated into the Euro-wide markets: market participants are generally satisfied with the overall size and liquidity of the former, while the latter has been developing rapidly although it is still relatively small.

30. **In relative terms, capitalization of the Dutch stock market is one of the highest in the Euro currency area.** However, the trade flows going through the Dutch stock exchange (which is merged with Euronext) are relatively low because major banks as stock brokers/market makers use their internal trading systems and use the stock exchange to trade the resulting net positions. On top of this, relatively high commissions and occasional trading

system glitches motivated some brokers to trade Dutch shares in the London Stock Exchange. Dutch equity brokers see the competition between the two exchanges as healthy.

31. **In the local stock market, as in other securities markets, Dutch pension funds and insurance companies continue to act as important risk buffers and sources of liquidity.** But the major Dutch players' ability to use European and global capital markets reduces the need to rely on other Dutch institutions and mitigates financial risks originating from the Dutch capital market itself.

32. **In recent years, Dutch financial institutions have increasingly made use of interest rate swaps for asset and liability management (ALM) purposes**. These include banks as well as life insurers that wish to increase the duration of their fixed income portfolio, given the long duration of their liabilities.

33. **Although to a lesser degree than other large banks, major Dutch banks play important intermediary roles in credit and other derivatives markets**. Their role in originating credit derivatives is relatively limited however, and they have so far been net buyers of credit protection. Dutch insurance companies do not appear to be major players in this market. At this point, the overall volume of credit derivative transactions is minimal compared to the overall assets of major Dutch banks.

III. Strengths and Vulnerabilities: the Financial Stability Policy Framework

A. Financial Regulation and Supervision

34. **The dominance of the Dutch financial system by a small number of internationally active LCFIs brings both important benefits and some costs.** The benefits arise in particular from greater diversification of exposures and risks, while the costs involve more complex supervisory, crisis management and possibly moral hazard ("too big to fail") concerns. The authorities response to this situation has essentially been to ensure particularly close supervision for the major LCFIs, and close cooperation and coordination with foreign supervisors.

35. **A second important aspect of the authorities' response is a comprehensive overhaul of the institutional structure and legal foundation for financial sector supervision, scheduled for completion by mid-2005.** This involves moving from a traditional, sectoral orientation to a functionally-oriented, cross-sectorally integrated supervisory system. All prudential supervision is being combined with the broader system stability and macroprudential surveillance responsibilities of the DNB, in what is now the

DNB/PVK;[10] while all conduct-of-business supervision is allocated to the Authority for Financial Markets (AFM).[11]

36. **The new framework is well designed and is expected to be more efficient and adaptable in the face of increasingly cross-sectoral and innovative financial activities, products, and risk management.** More broadly, by sharpening objectives, responsibilities and accountabilities, the new framework should ensure an incentive structure that is well aligned to effective ongoing supervision and surveillance. It is clear that the authorities have considered carefully and pragmatically a wide range of implementation issues in designing the framework, including the choice of the organizational boundary lines and how to manage the trade-offs that any such choice involves; the need to ensure effective and flexible collaboration between the two supervisory agencies; and the need to promote further development of macroprudential surveillance. There may be benefit in further clarifying to markets the differences they can expect in enforcement approaches, as between the prudential and CoB supervisors.

37. **The intention to further develop macroprudential surveillance is welcome.** Facilitated by the integration of research and policy analysis within DNB/PVK, a small, focused department has been established to take this task forward in a coordinated fashion. As part of this, data improvements may be needed in some areas (e.g., insurance and pensions sector aggregates), albeit within the broader objective of minimizing unnecessary administrative costs for supervised institutions.

38. **In addition, the comprehensive legal and regulatory overhaul is expected to address a few gaps in the current supervisory systems, which already compare well with the relevant international standards; and to formally establish a new, more active supervisory regime for pension funds.** The main areas in the current framework that need improvement are as follows (further detail is in the Annex to this report):

- Making more transparent the delegation of authority to supervisors in a few areas; and in those where the Minister will retain a final approval power in the new legislation (especially changes of ownership in the largest banks and insurers where they propose to take positions in each other) ensuring that the criteria governing such Ministerial decisions are clearly tied to the objective of maintaining financial system stability, and that the process would be fully transparent.

- Clarifying the budget approval process for supervisory activities. In the new law, the budget proposed by the supervisors' Supervisory Board will continue to require annual

[10] PVK (the prudential supervisor for insurance and pensions) has merged with DNB.

[11] Operationally, supervision will continue to be conducted mainly along sectoral lines for some time to come for stand-alone financial institutions, while supervision of each of the LCFIs will be carried out by a fully integrated cross-sectoral team.

final approval by the government. To minimize the potential for political pressures, or the perception of such vulnerability, the new law should set out formally the limited Ministry role in the process, and define clearly the grounds on which the annual budget approval might be withheld. Consideration could also be given to more explicit multi-period budgeting.

- Clarifying supervisors' objectives and accountabilities: the new law is expected to address this.

- In banking supervision specifically, extending fit and proper assessments to additional senior personnel, and also monitoring/reporting capital adequacy on a solo basis for non-guaranteed entities within banking groups.

- In insurance supervision, opportunities for improvements relate to transparency, actuarial and accounting practices, group supervision, market analysis, disclosure, frequency of reporting, and supervision of intermediaries.

- In securities regulation, the highest priority issue is to strengthen the powers to cooperate with foreign supervisors, even when there is no "domestic interest". Other areas are ensuring adequate oversight of accounting standards; strengthening and clarifying the licensing responsibilities of each regulator; and developing contingency plans for dealing with the failure of a market intermediary.

- On pensions regulation, a new regulatory regime is being established (Box 4). An appropriate degree of flexibility is needed for making up shortfalls in minimum solvency levels, to avoid unduly sharp and potentially procyclical reactions, but without unduly prolonging adjustment. Draft legislation currently specifies an adjustment period of 15 years to make up shortfalls relative to the minimum solvency position: the legislation should be clear that this is a maximum adjustment period—on a case-by-case basis it may often be appropriate for the adjustment to be faster than 15 years.

- On securities settlement systems, the main recommendations are to increase the clarity and fairness of Euroclear access rules, and to work with relevant counterparts to promote the development of DVP settlement links between Euroclear and foreign central securities depositories. The new law is expected to address the need for a stronger legal basis for supervision of such systems (as well as for payments systems more generally).

B. Safety Nets

39. **In a liquidity crisis, DNB can provide special credit facilities, but inevitably, for a large institution with liquidity problems, close coordination with other officials, in Europe and elsewhere, is likely to be required.** Such emergency credit, however, would be limited by the need for it to be fully collateralized, though what is eligible is not pre-specified. Although it is understandable that the DNB does not want to encourage moral hazard by being too clear as to the terms on which emergency credit would be provided, it

might nonetheless consider clarifying the general principles that it would follow in the handling of such an event. In addition, it might also consider publishing general information on the provision of such assistance some time after the event.

Box 4. Recent Changes in Pension Regulation

In December 2003 the government agreed on a new set of principles on the regulation of financial supervision of pension funds ('hoofdlijnen voor de regeling van het financiële toezicht op pensioenfondsen in de Pensioenwet'), which subsequently were modified after consultation with the social partners. In March 2004 the Dutch parliament agreed with this final draft. These principles will be incorporated in the new Pension Act planned for 2006. However, the agreement of the Dutch Parliament with the principles in March 2004 also implied that the PVK can immediately (as off March 2004) take the principles into account.

The most important change is the requirement that pension funds hold additional reserves if they index their pension entitlements to wage increases, unless they state explicitly that workers are not legally entitled to future indexation. The principles state that solvency ratios should be high enough to honor all pension liabilities at the end of the year with a confidence level of 97.5 percent. For many funds, this would translate to unrealistically high solvency ratios (near 200 percent) and drastic increases in premium levels (an additional 16 percent of gross wages) to take into account nominal pension entitlement plus promised or implied indexation.

However, when the indexation is conditional on future decisions of the management of the pension fund, solvency requirements are less strict. In this case, the solvency ratio should be high enough to cover only the unconditional entitlements (nominal pension entitlements plus accrued indexation) with a probability of 97.5 percent. For an average pension fund, this implies a solvency rate of around 130 percent.

The principles specify criteria that determine when indexation promises are regarded as conditional and when not. This includes transparency about indexation policy and the adoption of a disclaimer stating that pension indexation is conditional, that there is no legal right to indexation, and that it is also uncertain for the long term whether or not pension benefits will be indexed.

40. **In its approach to crisis management, DNB stresses the need for flexibility, good communications, and the ability to reach informed decisions quickly.** Its plans for handling a crisis in the financial system are based on a flexible, 'checklist' approach that recognizes that no two crises are likely to be identical. The checklist identifies key aspects such as priority information and questions to be addressed, contact lists, respective roles, and logistical and communications issues. In addition, DNB has developed good continuity-of-business arrangements for monetary operations and payments and settlements systems. While the checklist is likely to be extremely useful in ensuring a systematic approach to handling of a crisis, there is also likely to be value in participating in further simulation exercises and reviews with foreign supervisors.

41. **DNB also has the authority to appoint an undisclosed "silent receiver" to a troubled financial institution, who supervises and directs the management in restoring financial health.** While this may allow an orderly restructuring of a troubled institution, its undisclosed nature may cause a conflict with listing, governance or contractual arrangements.

As part of ongoing contingency planning, the authorities should review the potential for such conflicts, and consider how they would be handled.

42. **The system of *ex post*-funded deposit guarantees is currently under review.** Several issues will need to be considered, taking account of both the broader European context of depositor/investor protection arrangements, and the dominance of a few large institutions in the Netherlands, which raises potential "too big to fail" issues. The most basic issue is whether to introduce pre-funding of bank deposit insurance, and if so, the merits of risk-adjusted premia.[12] While there are arguments in both directions, the nature of the Dutch banking system strengthens the arguments in favor of at least partial pre-funding. In any event, the important point here is that a thorough analysis of the issues should be completed in the near future, in parallel with the overhaul of supervisory laws.

C. Tax and Quasi-fiscal Issues Related to Financial Stability

43. **Tax deductibility of mortgage interest remains extensive and phasing it out over time would support the maintenance of financial stability.** Wide-ranging tax deductibility has encouraged over-borrowing and could increase the amplitude of future housing price cycles. Because precipitous changes in the tax arrangements could be destabilizing, the pace and timing of further changes would therefore need to be carefully considered. But planning for a gradual phase-out should begin sooner rather than later, while the housing market is more subdued.

44. **The National Mortgage Guarantee Plan should also be reviewed over time, ideally within a systematic examination of the government's role in supporting housing finance.** The financial system distortions arising from this subsidized guarantee reduce overall financial sector efficiency, and the Plan may also have some stability implications if it exacerbates housing upswings, even while it offers protection on the downswing. Phasing out, or at least charging a market-related fee for the guarantee, should be actively considered.

D. AML/CFT Issues

45. **The Netherlands has a generally sound AML/CFT framework and, having ratified almost all relevant international conventions, it expects to ratify the Palermo Convention shortly**. The legislative framework for criminalizing ML and FT will be further enhanced by the new Acts of Terrorism Act. The assessment identified several areas that could be further strengthened, including: ensuring there is effective sharing of information by MOT with supervisory authorities; reducing the reliance placed on general provisions in

[12] Under the current system, DNB would provide financing of deposit insurance in the event of a bank failure and then recover its outlays over time from the remaining banks. For a small bank failure, this would not be problematic, but for a large bank failure, it might be unrealistic to recover the insurance outlays from the remaining banks. Pre-funding would reduce, but not eliminate the moral hazard problem. If smaller banks are more at risk than the large banks, however, premia should reflect such differences. Investor insurance in the securities industry is already partly pre-funded.

regulations relating to organization and control to impose quite specific duties on financial institutions for ongoing training, internal audit and procedures for reporting transactions; further consolidation of MOT and other law enforcement authorities in respect of resources and policy control; widening the scope for the application of administrative sanctions; providing detailed AML/CFT guidance to regulated institutions, and reviewing current arrangements where supervisory responsibility has been delegated under the provisions of the Act on the Supervision of the Credit System. In addition, a merger and updating of the two most important laws on preventive measures is currently under active consideration, and would be beneficial.

OBSERVANCE OF FINANCIAL SECTOR STANDARDS AND CODES—SUMMARY ASSESSMENTS

The annex contains summary assessments of international standards and codes relevant for the financial sector. The assessments have helped to identify the extent to which the supervisory and regulatory framework is adequate to address the potential risks in the financial system.

The following detailed assessments of financial sector standards were undertaken:

- The Basel Core Principles for Effective Banking Supervision (BCP), by Mr. Thordur Olafsson (IMF-MFD) and Ms. Jean Moorhouse (FSA, U.K.);
- IAIS Insurance Core Principles (ICP), by Mr. Michael Hafeman (OSFI, Canada), using the ICP methodology adopted in October 2003;
- The IOSCO Objectives and Principles of Securities Regulation, by Mr. Richard Pratt (formerly FSC, Jersey), using the methodology adopted in October 2003;
- The CPSS/IOSCO Recommendations for Securities Settlement Systems, by Mr. Jan Schullerqvist (Sveriges Riksbank), using the methodology adopted in November 1992; and
- The FATF Recommendations for Anti-Money Laundering Combating the Financing of Terrorism (AML/CFT), by Mr. Ian Carrington (IMF-MFD), Ms. Margaret Cotter (IMF-LEG), and Mr. Jack de Kluiver (Independent AML/CFT expert, Department of Justice, USA).

The assessments were carried out during a mission to the Netherlands from October 27 to November 7, 2003, with the exception of the AML/CFT assessment, which was carried out from December 1–12, 2003. All the assessments were based on the laws, regulations, policies and practices in place at the time the assessments were made.

The assessments were based on several sources including:

- Self-assessments by the supervisory authorities;
- Reviews of relevant legislation, decrees, regulations, policy statements and other documentation;
- Detailed interviews with the supervisory authorities; and
- Meetings with other authorities and independent bodies, including the Ministries of Finance, Justice, and Social Affairs and Employment, Euronext, Euroclear, Clearnet, the Actuarial Society, the Institute of Registered Accountants, and auditing firms.

Meetings with the financial sector firms and associations, including banks, securities firms, insurance and pension companies, the Association of Company Pension Funds, and the Association of Industry-wide Pension Funds.

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Main findings

Objectives, autonomy, powers, and resources

46. The basic legal framework is set out in the 1998 Bank Act, supported by the Act on the Supervision of Credit Institutions 1992 (ASCS). The Bank Act gives the DNB powers to exercise supervision of financial institutions in accordance with applicable legislation. The legislation also provides the Ministry of Finance powers to exercise certain supervisory measures. Furthermore a number of financial institutions are also subject to the Act on the Supervision of the Securities Trade. It is intended that introduction of the new Financial Supervision Act will reflect the reformed structure of financial sector supervision and allow

for the full implementation of the new capital accord. This should help to improve the transparency and clarity of supervisory responsibility. In addition, the objectives of the DNB are only implicitly embedded in the legislation rather than being explicitly set out and published. The new legislation will be an opportunity to strengthen this aspect and make accountability easier to measure.

47. Currently the DNB is centrally funded but there are plans to transfer the responsibility of much of the funding to the financial sector. A fee based system is to be introduced on a graduated basis over the next three years.

Licensing and structure

48. Banking legislation in the Netherlands does not explicitly define the activities a credit institution may undertake. This is because Dutch law embraces the concept of universal banking. However, the legislation is sufficient to ensure that a bank can undertake at a minimum those activities covered by the European Banking Coordination Directive. In addition, a bank may carry out activities relating to securities and insurance business (the latter requires a further regulatory license). Therefore, the licensing criteria are clear and quite broad ranging. In terms of limitations, institutions are restricted from using the name "bank" in most circumstances unless they have been authorized under the ASCS. In addition, deposit taking is not permitted except for authorized credit institutions.

49. As regards ownership criteria the system is slightly more opaque. Though both the approval of shareholders and the power to accept or reject a transfer of ownership or controlling interest would appear to rest with the Ministry of Finance, the decision is always taken on the advice of the DNB. The mission notes that the Dutch authorities are considering ways of streamlining the authorization process which, if implemented will improve transparency. Furthermore, the DNB is responsible for the assessment of the fitness and propriety of members of the Supervisory and executive boards but does not formally consider such criteria for the banks' senior management. The mission suggests that the DNB expand their coverage to include banks' senior management.

Prudential regulations and requirements

50. The DNB's prudential regulations are consistent with the requirements of the EU financial directives. They are comprehensive in coverage but are generally only required on a consolidated basis rather than both solo and consolidated basis. As part of their preparations for the new Basel Capital accord, the DNB is considering how it can most effectively extend its prudential reporting requirements on a solo basis to parent banks. It is also carrying out a complete overhaul of its procedures to ensure they reflect the new Financial Supervision Act.

51. The detailed prudential requirements seem comprehensive and adequately specified. There is a comprehensive and robust system to take into account sovereign risk. In addition, though no formal or prescriptive loan loss requirements are set out by the DNB as the provisioning system is principle rather than rules based, this seems to work well in practice. The benefit of such a system is that loan loss provisioning remains an active, ongoing risk

mitigation tool of asset quality of the banking sector. However, to strengthen its supervision of credit quality, the DNB undertakes on site external examinations of the credit quality of the institutions and may if it so wishes overrule the provisioning levels recommended by the external auditor.

52. The DNB also uses a comprehensive range of tools to ensure that the banks are able to measure, monitor and control market risk. This includes the use of 'capital market specialists' to review the banks own internal risk models. Their policies in respect of the need for banks to have sound internal controls and acceptable corporate governance procedures are also extensive.

53. Rules and regulations regarding anti-money laundering are not covered specifically by the current banking legislation. As anti-money laundering goes beyond the banking system a range of legislation has been introduced to cover all areas of the financial system. These appear comprehensive. However, the system would be enhanced were the regulations to require that the banks appoint a designated 'money laundering reporting officer' who has senior status within their organization rather than allow a wider compliance function to undertake the role. This task could for example be given to a compliance officer.

Methods of ongoing supervision

54. An effective banking system is one which has some form of both onsite and offsite supervision. The process in the Netherlands in this respect seems balanced and appropriate. Onsite examinations occur in line with the risked-based assessment of the bank. Contact with senior management occurs on a regular basis both during onsite examinations and when appropriate on an ad hoc basis to cover specific policy issues. There are also annual meetings with the banks' external auditors. The DNB has a comprehensive risk assessment system. However, the mission felt the risk process would benefit from the overall assessment being communicated back to the bank in question. As far as other aspects of offsite supervision the information received on a consolidated basis was comprehensive and thorough. A robust independent validation process also appeared to be in place.

Formal powers of supervisors

55. Though the legal powers given to the DNB are wide ranging and would appear to cover almost all (if not all) eventualities, more formalized measures are rarely used in practice. Notwithstanding, there are established procedures on how to implement such measures if called for. These measures tend to be persuasive and confidential in nature including the use of the 'silent receiver' in cases of substantial concern. This system appears to work effectively and reflects the overall culture of the DNB. However, the introduction of new legislation which will involve a greater degree of transparency may result in the authorities needing to reconsider their approach. In particular, it may be worthwhile for the DNB to ensure that the powers they use when appointing a 'silent receiver' are consistent with the relevant stock exchange disclosure requirements when the bank concerned is a publicly quoted company. Furthermore, it can be questioned whether 'penalties' can be applied to management rather than just members of the Supervisory and Executive boards.

Cross-border banking

56. The DNB's approach to global consolidated supervision appears to be comprehensive and effective. The teams dealing with the larger global groups seem to have the appropriate mix of resources to assess the risks. The consolidated prudential returns are received regularly. In addition, the risk model used is sufficiently flexible to accommodate both group and single entity assessments. The DNB's supervisory staff visits the overseas parts of their groups on a regular basis in addition to placing a degree of reliance on overseas regulators. Their approach to sharing information with overseas supervisors seemed open and cooperative and where possible is supported by an MOU. Where this is not possible because legal equivalence cannot be established informal arrangements seem satisfactory.

57. Banking supervision in the Netherlands is applied to the same standard for 'foreign' banks as it is to the domestic sector. In the main, the DNB has a preference for subsidiaries to be established rather than branches of non-EEA banks and always ensures that the agreement of the home supervisor is obtained before authorization is granted.

58. The DNB tries to deter banks from countries who do not have 'equivalent standards of supervision,' preferring subsidiaries to be established instead. However, there does not seem to be a formalized way of assessing equivalent standards of supervision. The DNB may wish to consider strengthening its methodology for assessing overseas regulators. They may wish to consider these both in terms of the reliance that can be placed on overseas regulators in respect of overseas banks in the Netherlands and Dutch banks operating on a global basis.

Authorities' responses

59. The Netherlands authorities agree with the main findings of the assessment, which they consider to be fair and comprehensive. They are satisfied with the overall judgment that banking supervision in the Netherlands complies to a very high degree with the Basel Core Principles.

60. Many of the recommendations that have been made will be addressed in the bill on financial supervision that is due to come into effect in 2005. In other cases, the authorities will consider the recommendations seriously. In some instances, it is already the intention to introduce such measures, e.g., requiring banks to designate a senior-level money laundering reporting officer. In other instances the potential benefits of such measures will need to be weighed against potential costs, especially in terms of administrative burdens on supervised institutions.

Table 4. Recommended Action in the Area of Banking Supervision

Reference Principle	***Recommended Action***
Objectives *CP 1(1)*	New law to set out clearly the responsibilities of the various supervisory authorities, to require that objectives are explicit and indicate how accountability will be measured.
Independence *CP 1(2)*	New law to improve the transparency of the system and improve the independence and transparency of the supervisory authorities.
Legal Framework *CP 1(3)*	New law to ensure that explicit legal powers exist to set prudential rules in respect of integrity.
Licensing criteria *CP 3* ***Remedial measures*** *CP 22*	A review of the adequacy of the fitness and propriety requirements to be undertaken to ensure they capture all personnel in key senior management positions. This should be extended to the powers needed to take remedial action.
Ownership *CP 4* ***Investment criteria*** *CP 5*	New law to ensure that there is transparency about who is the authorizing (licensing) body The law also needs to give the supervisory body exclusive powers to approve or reject the transfer of significant ownership.
Capital adequacy *CP 6* ***Connected lending*** *CP 10* ***Off- site supervision*** *CP 18*	Prudential reporting to be extended to capture institutions at the solo as well as the consolidated level. All prudential ratios (such as connected lending and lending to closely related counterparties) to be monitored at the solo level for entities within a banking group that are not fully guaranteed.
Internal control and audit *CP 14*	The requirements for an audit committee to be both strengthened and wider to cover all but the smallest institutions.
CP 15	The DNB to require banks to have a designated 'money laundering reporting officer' who has senior status within the organization.
On-site and off-site supervision *CP 16*	DNB's risk assessment process would benefit from a slightly more structured approach. It is recommended that an initial assessment of high level controls and group risks is made before more detailed aspects are considered, and that an initial assessment of high level controls and group risks is made before more detailed aspects are considered, and that the overall assessment is communicated back to the bank.
Supervision of foreign banks *CP 25*	DNB to consider formalizing its approach to peer assessment of overseas supervisors both in respect of those countries, which have foreign banks, established in the Netherlands and those countries where their domestic banks are operating.

IAIS Insurance Core Principles

Main findings

61. There is a high level of observance of the ICP in the Netherlands. A number of the recommendations for enhancement of the supervisory framework relate to the need for more complete and explicit guidance to industry regarding supervisory expectations, as both supervisory guidance and professional standards, e.g., for the actuarial profession, are in some cases either absent or fairly high level in nature. Greater transparency by the supervisor in several areas, e.g., the stages of supervisory intervention, has also been recommended. The authorities in the Netherlands are actively pursuing initiatives that hold the potential to materially improve the level of observance in the coming months or years. Implementation of the proposed financial assessment framework, along with its new risk-based supervisory methodology, should place the PVK solidly among the international leaders in insurance supervision.

Conditions for effective insurance supervision

62. The Netherlands meets the conditions necessary for effective insurance supervision.

The supervisory system

63. The restructuring process currently underway presents an opportunity to clarify and formalize the objectives and responsibilities of the supervisory authorities. The PVK is working on codifying and publishing its policies and procedures, a commendable initiative that should be expanded in the interest of even greater transparency. While the PVK actively exchanges information with other EU/EAA supervisors, these practices should be extended to other regions, in light of the broad international scope of some leading Dutch financial groups; doing so would also improve the observance of other CPs, e.g., licensing and group-wide supervision.

The supervised entity

64. Both reinsurers and some very small insurers are unlicensed, and steps should be taken to do so or, at least require registration. More explicit guidance on corporate governance and internal control, along with legislative changes to help ensure the flow of information from the external auditor and the actuary, would improve observance.

On-going supervision

65. The PVK's new MARS methodology is consistent with international best practices, although it is important that adequate resources be available for its successful implementation. Increasing the information available to supervisors, e.g., through active market analysis and quarterly financial returns, would facilitate a more dynamic off-site monitoring process.

Prudential requirements

66. The ability for the supervisor and others to assess the financial condition of insurers could be improved by narrowing of the range of acceptable actuarial and accounting practices. The PVK is relying upon developments internationally, e.g., the evolution of International Financial Reporting Standards, to address some of these issues, and is actively involved in international standard setting initiatives. The FTK project, when completed, should result in a forward-looking, risk-sensitive solvency regime—a significant step forward. However, further steps might also be taken in the shorter term to improve the level of observance, such as providing more detailed guidance on risk management issues.

Markets and consumers

67. Supervision of insurance intermediaries is weak, and certain aspects of consumer protection could also be strengthened. Legislation currently being drafted, along with the expansion of the AFM's responsibilities, should increase the level of observance. Disclosure practices are expected to improve with the move to IFRS, although supplemental guidance may be appropriate.

Anti-money laundering, combating the financing of terrorism

68. More explicit guidance has been recommended to emphasize the need for foreign branches and subsidiaries of Netherlands insurers to observe AML/CFT measures.

Table 5. Recommended Actions in the Area of Insurance Supervision

Reference Principle	*Recommended Action*
The supervisory system *CP 2–5*	The principal objectives of insurance supervision should be explicitly defined in legislation. The responsibilities of the PVK and the AFM for various tasks should be clarified. Continue initiatives to publish more information about policies and procedures, and expand to include information on stages of intervention, interpretations, and risk assessment criteria. The PVK's usual industry consultation process should be documented, published and observed to the extent possible. The PVK should exchange information with relevant supervisors outside of the EU/EEA, both during the licensing process and to enhance the supervision of groups.
The supervisory system *CP 6–10*	Steps should be taken to require that reinsurers, other than those supervised elsewhere in the EU/EEA, be licensed by the PVK. Enact legislation to require all insurers operating in the Netherlands, regardless of their size and nature, be registered with or licensed by the PVK. The PVK should publish lists of registered and licensed insurers on its website, and explain differences in the supervision of each category. The PVK should establish specific criteria to assess the fitness and propriety of auditors

	and actuaries, relying upon the requirements of professional organizations to the extent possible. The PVK should provide more explicit guidance on the governance practices and internal controls it expects of insurers, and require that they document significant policies, procedures and responsibilities. Enact legislation to enable the PVK to obtain information from either the actuary or the external auditor on a confidential basis, and to provide them strong legal protection against potential liability in such cases. Legislation should also provide for direct access to the board by the actuary.
On-going supervision *CP 11–17*	The PVK should assign an individual or department the ongoing responsibility of gathering quantitative and qualitative market information from both internal and external sources, analyzing this information, and communicating the results of the analyses to others within the PVK. The PVK should consider requiring basic supervisory returns quarterly. The PVK should publish on its website key financial information contained in those portions of the supervisory returns that are already open to public inspection. The PVK should reassess the staff resources required to successfully implement the MARS supervision methodology and seek additional resources, as necessary.
Prudential requirements *CP 18–23*	The PVK is in the process of issuing more detailed guidance; it should include: • The need for strategic underwriting, pricing and reinsurance policies; • The main elements of an investment policy; • Expectations regarding investment risk management systems, controls and contingency plans; • Expectations regarding the vetting of models and the independent verification of price, in connection with the use of derivatives and similar commitments. If the development of IFRS for insurance contracts is further delayed, the PVK should take steps to reduce the range of actuarial and accounting practices in the Netherlands and to ensure that complex actuarial issues, such as the valuation of embedded options, are being dealt with adequately. The PVK should finalize the design of the FTK and implement it in accordance with the current timetable. If delayed, the PVK should consider establishing and communicating a solvency control level.

Markets and consumers *CP 24–27*	Enact legislation to provide a stronger and more comprehensive basis for the supervision of insurance intermediaries. Enact legislation or guidance to require that consumers be provided information about potential conflicts of interest, that policies be in place on fair treatment, and that information be sought to assess insurance needs. Issue guidance to promote improved disclosure of risk exposures (both qualitatively and quantitatively), risk management practices, and management and corporate governance issues.
Anti-money laundering & combating the financing of terrorism *CP 28*	Issue guidance to emphasize the need for foreign branches and subsidiaries of Dutch insurers to observe AML/CFT measures.

Authorities' responses

69. The Netherlands authorities agree with the main findings of the assessment, which they consider to be fair and comprehensive. The authorities concur with the overall judgment that insurance supervision in the Netherlands is ´largely compliant´ with the revised Insurance Core Principles of the IAIS, dated October 2003.

70. The authorities welcome the IMF observation that many of the suggestions for improvement that have been identified are already being addressed. Some of the points raised are being included in the bill on financial supervision that is due to come into effect in 2005 (ICP 2), in other legislation (ICP 24 en 25) or are being addressed on EU level (ICP 6, 20). On other points, the authorities are already taking action on the recommendations regarding more transparency of the policy making process and an elaboration of the policy rules in a number of areas, market analysis and solvency assessment (ICP 4, 7, 9, 10, 11, 19, 20, 23). The authorities welcome the IMF observations as an encouragement and support for the steps that have recently been taken.

71. The authorities also welcome the recommendations and suggestions regarding:

- The need for close international cooperation and information sharing (ICP 5, 6, 17);
- Supervision of small insurers and transparency of supervisory arrangements (ICP 6);
- Increasing the frequency of filing of insurers' supervisory returns (ICP 12);
- Resourcing of on-site supervision (ICP 13); and
- Increased public disclosure by insurers (ICP 26).

72. In some cases, action will be taken to implement recommendations, while in some other areas, the benefits of the recommendations will need to be weighed against other considerations or costs.

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

Main findings

73. The Netherlands financial regulatory system demonstrates a high degree of compliance with the IOSCO objectives and principles. The implementation and enforcement of the regulatory regime is achieved through effective regulatory bodies, with extensive investigatory powers and a developing risk based approach. The authorities are embarking upon a regulatory transformation which will be largely complete with the introduction of a new law in 2005. The new law is intended to address most of the relatively few instances where the assessment indicates departure from IOSCO objectives and principles.

The Regulator (Principles 1–5)

74. The main statutory regulatory bodies are the DNB and the AFM, although the Minister of Finance has some reserved powers—to recognize exchanges and to provide exemptions from regulation. The main Self Regulatory Organization is Euronext. This currently is the Listing Authority. In addition, accounting standards and auditing standards are subject to supervision by the Council for Annual Financial Reporting and the auditing organizations NIVRA and NovAA. The AFM will take on responsibility for listing and for accounting and auditing standards under the new law.

75. Because the transition to the twin pillars approach is not yet complete, the split of responsibilities between the two regulators is not at present entirely clear to the market. Further clarity is therefore important.

76. The regulatory bodies are independent in taking day-to-day decisions. However, they are subject to annual budgetary approval by the Minister of Finance; they do not have immunity from civil action against them for actions taken in good faith (although staff are protected and there is a guarantee from the Ministry of Finance); regulatory policy is subject to an informal and effective but somewhat non-transparent consultation process with the Ministry of Finance and the criteria by which the Minister of Finance takes the reserved decisions are not published. Addressing these issues should assist in providing the regulatory bodies with a greater degree of independence on policy—to reinforce the already high degree of independence on day-to-day decision making.

77. For most areas of regulation, the AFM publishes highly specific rules as Further Regulations. However, in the case of the Collective Investment Schemes (CISs), there are fewer rules and greater reliance on policy documents and general fitness and properness requirements. This reflects the legislative legacy and will be amended by new legislation. The ideal degree of reliance on rules and general principles may lie somewhere between the current practices for CISs and other areas.

Principles of Self Regulation (Principles 6–7)

78. Euronext is the main SRO. It is supervised by the AFM but responsibility for recognition lies with the Minister of Finance. This is a historical legacy which the authorities should change in the new law.

Principles for Enforcement (Principles 8–10)

79. The regulatory bodies have adopted a risk-based approach to regulation. In the case of the AFM, this is founded on a "contribution" self assessment questionnaire. This technique is being developed but has potential to be an effective approach especially if the regulated entity were invited to comment on the significance of any regulated weaknesses it identifies.

80. The two regulatory bodies take different approaches to enforcement. The DNB tends to operate at an informal level with little use of formal sanctions. The AFM also uses informal methods but has deployed sanctions more frequently. Both approaches are valid in context for prudential and conduct of business regulators respectively. Industry has expressed concerns about the use of sanctions by AFM and these concerns should be allayed—perhaps through a public awareness campaign drawing attention to the similar use of sanctions powers by regulators internationally and the safeguards built into the AFM processes.

81. Although there are broad and effective powers, there are some areas where expansion, greater clarification or specificity could help. These include the expansion of the list of entities from which information can be obtained and an explicit requirement that information supplied be accurate.

Principles Relating to Co-operation (Principles 11–13)

82. The regulatory bodies show a high commitment to co-operation both domestically and internationally. However, they are unable to investigate on behalf of a foreign regulator, where they have no domestic interest in the investigation. Legislation to remedy this is in prospect. It is important that it be implemented as soon as possible, for without it, The Netherlands cannot sign the IOSCO multilateral Memorandum of Understanding.

Principles Relating to Issuers (Principles 14–16)

83. The Netherlands have comprehensive requirements relating to issuers, many of which are specified in the Civil Code and others in the 1995 Act on the supervision of the Securities Trade. The AFM will be taking on responsibility for accounting and auditing standards and will become the listing responsibility. These changes are designed to enhance the effectiveness of the regime.

Principles Relating to Collective Investment Schemes

84. Responsibility for Collective Investment Schemes regulation has recently passed from the DNB to the AFM. The approach is more principle than rule-based. In some areas,

the AFM has issued policy statements but relies, for enforcement, on the proposition that a failure to abide by policy statements would cast questions on fitness and properness. The absence of major problems in the sector suggests that this approach has been effective. However, in future, the AFM may need something more directly enforceable and this will be possible under new legislation.

85. The Netherlands do not require a CIS to entrust assets to an independent third party custodian, when the CIS is itself a company. This means there is no independent party to oversee the actions of the CIS and ensure, for example, that asset disposals are in line with the terms of the CIS.

Principles Relating to Market Intermediaries (Principles 21–24)

86. The current arrangements for licensing have the result that the DNB is the licensing authority for many entities that are important participants in the securities business, or even whose main activity is in that business. The covenant between DNB and AFM demands consultation on licensing decisions. Nevertheless, securities businesses are more likely to raise conduct of business issues and therefore it would be preferable if licensing decisions which permitted an entity to conduct securities business were subject to the explicit consent of the AFM.

87. The authorities need to develop a clear plan for dealing with the failure of an intermediary, that includes the action to be taken by all regulatory authorities.

Principles Relating to Secondary Markets (Principles 25–29)

88. Euronext Amsterdam is an order-driven screen-based exchange, trading cash and derivative products. It is part of the Euronext group. Its current and proposed trading engines have a good pedigree (being based on the French system, for cash, and the British system, for derivatives).

89. The AFM intervention powers are limited to matters relating to the rules, so they are technically unable to intervene on, say, IT matters. This could be resolved and transparency increased by specifying recognition criteria/performance objectives and giving AFM the power to intervene in furtherance of these objectives.

90. Some 15 percent of trades by value (but only 1 percent by volume) are not reported to the market because of the rules applying to trades outside certain price and volume limits. These arrangements should be reviewed to enhance transparency to the market.

91. The MOU with the other Euronext regulators covers harmonized matters. National supervision of an international exchange creates regulatory burden and delay in resolving issues that puts Euronext at a competitive disadvantage vis-à-vis London and Frankfurt. Increased harmonization of regulation, or joint regulation would improve matters.

Table 6. Recommended Actions in the Area of Securities Regulation	
Reference Principle	***Recommended Action***
Regulator *(P 1–5)*	Finalize and publish the practical division of responsibilities between AFM and DNB; enhance industry awareness and clarify how they propose to deal with regulatory overlaps. Develop an explicit plan and timetable to provide for the takeover of responsibilities so that both AFM/DNB and Euronext understand fully their respective role throughout the process of transition of listing and other responsibilities Consider publishing criteria for determining exemptions from regulatory requirements under the law where the power is reserved to the Minister Review the balance between the level of detail in the Act, Decrees and Further Regulation in the light of experience and industry comments Consider an explicit legal requirement that the Minister consult the regulatory bodies before exercising his retained powers, where those powers relate to financial service regulation. Consider allowing the AFM to go to the court to seek restitution or have direct powers themselves to order restitution, subject to proper procedures. Discuss with representatives of the smaller market participants their concerns about the consultation process and how to address them. The authorities are recommended to reinforce the independence of the regulator by: • Providing for budget approval over a longer period—such as 3, or preferably 5 years; • Providing for the regulatory bodies to build up reserves to meet contingencies; • Increasing transparency, so that the proposals of the regulator for legislation and Further Regulations and the comments of the MOF are public; • Requiring any general direction made by the Minister to the regulatory bodies to be public; • Giving investors representatives the opportunity to comment on the regulatory authority budget along with the industry market panel.
Self-Regulation *(P 6–7)*	Develop and publish in greater detail the criteria the Minister would adopt for a recognition decision and therefore the standards against which Euronext is assessed. Give the power to recognize SROs to the regulator with oversight. The AFM and Euronext are recommended to reach a common and explicit understanding as to the role of AFM in approving or commenting on Euronext rule changes
Enforcement of Securities Regulation *(P 8–10)*	Give AFM and DNB the power to obtain information from anyone they reasonably believed had the information required, and ensure the accuracy of information provided by regulated entities to the AFM or DNB. Consider ensuring that regulators are permitted to require a person to make a statement, and consider expanding the range of sanctions to include public statements. Promote public awareness of the international standards that require effective enforcement powers by a regulator of securities institutions. That campaign should emphasize the safeguards built in to the AFM processes that protect the subject of enforcement action. Review the exercise of powers by the two regulators to satisfy themselves that all the appropriate powers are available to both regulators and to draft the new law so that there are no gaps. Consider an explicit provision to allow the regulators to apply to the court to appoint a manager of a regulated institution in substitution for the existing management. Consider inviting each regulated entity explicitly to make an assessment on the significance of any compliance weaknesses they identify in the model.

Cooperation in Regulation *(P 11–13)*	Introduce legislation as soon as possible to allow the AFM and DNB to exercise their investigative powers on behalf of a foreign regulator even where there is no domestic interest.
Issuers *(P 14–16)*	Limit the extent to which the exemptions from prospectus requirements apply when an offer is made to a large number of people.
Collective Investment Schemes *(P 17–20)*	Extend the regulatory requirements to cover all those providing functions for CISs. Ensure that the new legislation provides for powers to make specific rules on conflicts of interest and record-keeping that are adequately enforceable, and introduce specific requirements for the maintenance of books and records in relation to transactions involving CIS assets and all transactions in CIS shares or units or interest.
Market Inter-mediaries *(P 21–24)*	Make publicly available the names of the senior management of regulated entities. Ensure that licensing decisions for each area of activity, are taken with the consent of the regulator with primary responsibility for that area of activity, and that permission for such activities be withdrawn if the regulator with primary responsibility for its supervision advises that this is necessary. Require all regulated entities to notify the regulator of any matter which would materially affect a licensing decision and also add to the list of specific matters, litigation against the company, significant investigations or disciplinary action by regulators in other jurisdictions, changes in indemnity insurance and any decision by a foreign regulatory authority to refuse a license. Credit institutions should be required to notify the AFM of breaches in conduct of business regulations. Make all persons in a position to control or materially influence the applicant for a license subject to checks by the AFM and DNB. Introduce a legal requirement that the legal and regulatory obligations should be met and that the intermediary should act with honesty and integrity and observe high standards. Establish a clear plan for AFM and DNB to deal with the eventuality of a firm's failure that includes appropriate disclosure to the market.
Secondary Market *(P 25–30)*	Finalize the Contribution model for Euronext as soon as possible consistent with Euronext's position as a pan-European exchange. The AFM should seek to expand the MOU amongst the five regulators so as to encompass all harmonized matters (to the extent that it is not already). The AFM and Euronext should review the rule relating to block trades with a view to enhancing the transparency of the market.

Authorities' responses

92. The Netherlands authorities are pleased with the positive assessment of the Netherlands' observance of the IOSCO-principles and is in broad agreement with the conclusions of the IMF. As the Dutch supervisory structure has been undergoing some major changes recently, the opinions and recommendations of the IMF are helpful in further developments. Several recommendations will be taken into consideration in completing the legislation. With regard to some specific conclusions and developments, the authorities note the following:

- Regarding the budget process for the supervisory bodies, the authorities believe that there are already substantial safeguards to protect the independence of the supervisors from the Ministry of Finance;

- Recommendations regarding the clarification of DNB-AFM areas of responsibility, including licensing responsibilities, addressing industry concerns, and efforts to enhance industry understanding of the role of the AFM are well taken, and these issues are being addressed by a variety of means, including a review of the DNB- AFM Covenant, publications, and meetings with market participants;
- The issues raised regarding recognition of exchanges (P 6–7), supervision of Euronext (P 25–29) will be evaluated in the context of the bill on financial supervision.
- The authorities recognize the need to review the supervision of Collective Investment Schemes, and also the need for developing clear plans for dealing with the failure of an intermediary, and steps are being taken to address these issues.

PAYMENTS AND SECURITIES SETTLEMENT SYSTEMS—CPSS/IOSCO RECOMMENDATIONS FOR SECURITIES SETTLEMENT SYSTEMS (RSSS)

General

93. Major features of the Netherlands payments system were reflected in the assessment of the Europe-wide TARGET payments system that was undertaken in 2001. That assessment found that the TARGET system was broadly compliant with the Committee on Payment and Settlement Systems (CPSS) Core Principles for Systemically Important Payments System (CPSIPS). Given this, the FSAP did not formally assess payments systems in the Netherlands. Instead, attention was focused on securities settlement systems in light of recent and pending developments in this area, using the CPSS/IOSCO RSSS.

94. The systems covered by the assessment are those for government bonds, corporate bonds, stocks and derivatives traded on the markets organised by Euronext Amsterdam N.V. and its subsidiaries. These securities are all cleared through Clearnet and settled through Euroclear Netherlands (ENL) or Euroclear NIEC[13] (NIEC). The scope is extended for OTC transactions which are also settled by ENL or NIEC, but not cleared by Clearnet. The Dutch Securities settlement market is dominated by five banks—ABN AMRO, ING, Rabobank, Fortis and KAS Bank.

Main findings

95. The overall assessment is that the systems used for clearing and settlement of securities, Clearnet and Euroclear Netherlands respectively, are reliable and effective.

[13] Euroclear NIEC (Nederlands Interprofessioneel Effecten Centrum) is a securities settlement system offering custody and settlement services related to securities other than those admitted to the securities book-entry transfer system.

Legal risk

96. All laws and regulations with relevance for securities clearing and settlement are publicly available. The most important are the Bankruptcy Act and the Securities Giro Act. Given that securities clearing is done under French law, French legislation is also relevant. The rules of Clearnet, ENL and NIEC are publicly available and generally clear. The laws, regulations and rules support enforcing of transactions, protection of customer assets, immobilization and dematerialization, netting, securities lending and delivery versus payment. There are adequate rules for addressing the event of a participant default, including the effective use of collateral, and these rules can legally be enforced. The "zero-hour" rule is generally applied in relation to bankruptcy.

Pre-settlement risk

97. Securities transactions are electronically confirmed between direct market participants on the trading day. For indirect participants, timing of confirmation depends on the specific contractual arrangements. Settlement takes place within a three day cycle. For exchange-traded securities timely settlement guaranteed through the use of a central counterparty, Clearnet. Clearnet has adequate risk controls that include initial margin and daily settlement of variation margin. The clearing members contribute to a clearing fund. Margin and clearing fund are sufficient to cover for a default by the clearing member with the largest exposure. In addition there are other financial resources available. Securities lending is available in the market and has the necessary legal foundation.

Settlement risk

98. Securities, including government securities, are mainly kept in book-entry form, even though only a minor part is dematerialized. The beneficial owner has a co-ownership in securities held in book-entry form. There is no registration of securities transfers outside the CSD. All settlement are made with delivery against payment, DVP, with the delivering party's securities being reserved while cash settlement takes place. However, only about 70 percent of the transactions are settled DVP, partly due to settlement over FOP cross-border links. Finality of the cash leg is achieved at the moment of the cash transfer, and finality of the securities leg is following immediately after this cash transfer.

99. OTC-transactions are settled gross, i.e., DVP model 1. Settlement of OTC-transactions takes place every thirty minutes (the cash leg) during day-time and once during the evening. Hence final settlement can be achieved intraday for OTC-traded securities. Settlement of exchange-traded securities that are cleared through Clearnet are settled net once a day, i.e., DVP model 3.

100. The CSD does not provide credit in any form, and there is no net settlement as such in the CSD. However, there is net settlement within the CCP, but the risk controls are sufficient. Ninety-five percent of all cash settlement takes place in central bank money. The remainder, settlement in foreign currency, is settled in KAS Bank, a supervised bank.

Operational risk

101. Both ENL/NIEC and Clearnet has adequate security and contingency planning for their systems. The ENL/NIEC systems are operated by Euroclear Bank, Brussels under a Service Level Agreement. Euroclear Bank has an alternative production site available with mirrored information. ENL/NIEC has an alternative business site available in Amsterdam. Clearing21 used by Clearnet is operated out of Paris by an affiliate to the Euronext Group. Also for this operation is available an alternative production site.

102. Both institutions regularly test their contingency plans. The settlement at ENL was delayed in June 2003, due to a mistake made by the service provider. Appropriate measures to prevent a similar incident have been taken.

Custody risk

103. Book-entry securities held in custody in accordance with the Securities Giro Act are protected by the law. For other securities, the supervisory laws have extensive regulation for separation of assets and requires that customer securities are kept with a separate specialized custodian. Holdings of securities are to be reconciled at least monthly.

Other issues

104. In some cases, all types of entities are not treated equal in the access rules of ENL. Credit institutions (banks etc.) from outside the EEA (the European Union, Iceland, Liechtenstein and Norway) are not allowed participation. Participation is also not possible for investment firms (securities firms), whether Dutch or foreign. There are also examples where the access rules are not completely clear.

105. Both ENL and Clearnet are regarded as effective by the users. They both monitor and benchmark their cost levels. The CSD uses SWIFT communication standards. Generally ENL and Clearnet are transparent with regard to risks, rules and procedures except for a few minor exceptions. Both ENL and Clearnet have close cooperation with its users through Market Advisory Committees and other user forums. Both institutions have also close cooperation with DNB and the AFM, through which the public interest is channeled.

106. DNB and the AFM oversee ENL, NIEC and Clearnet in an efficient way. DNB has as one of its tasks the promotion of a smoothly functioning the payment system, with an implicit legal basis for oversight of securities clearing and settlement systems. DNB and the AFM have developed a supervisory framework for clearing and settlement. The prudential supervisor for Clearnet is however the relevant French authority. The AFM is formally the supervisor of ENL being a book-entry system. However, since there is no formal direct legal foundation for supervision of securities clearing and settlement, but an explicit legal basis for the market conduct supervision by the AFM and oversight by DNB, an indirect approach has been used to supervise and oversee these activities. This was achieved by making oversight and supervision of clearing and settlement a condition for granting Euronext license as an exchange.

107. The CSD has a number of links, but none of these links support settlement with delivery versus payment. The links as such does not impose risks to the users.

Table 7. Recommended Actions in the Area of Securities Settlement Systems

Reference recommendation	Recommended action
Recommendation 7	The AFM and DNB should generally promote the use of DVP for settlement, and support any changes that could enhance the possibility of achieving DVP. With regard to settlement through cross-border links, DNB and the AFM should consider the recommended actions for Recommendation 19.
Recommendation 14	The AFM and DNB should approve a proposal from ENL to admit investment firms as participants. The AFM and DNB should further suggest to ENL, and when applicable NIEC, to review their Admission Regulation so they become open and fair. In such a revision the authorities and the system operators should consider allowing supervised non-EEA credit institutions to participate. The review should also consider making sure that the Admission Regulation is fully consistent with the practice used. In that context the requirement for foreign CSDs to be supervised should be put in the Regulation.
Recommendation 18	The MoF should finalise the project for a Financial Supervision Act as soon as possible, ensuring that operators of clearing and settlement systems are subject to direct supervision. The roles of the AFM and DNB should be clear and unnecessary overlapping should be avoided.
Recommendation 19	In addition, though not needed to improve observance, the AFM and DNB should support the Euroclear initiatives to develop cross-border DVP links, and they should further promote that system participants require such links in order to reduce risk. The Dutch authorities are dependent on the participation by the authorities in other countries in order to achieve such cross-border solutions.

Authorities' responses

108. The authorities are in broad agreement with the assessment of the securities clearing and settlement systems and the general overview of payment systems. Part of the recommendations will be addressed with the enactment of the Financial Supervision bill. This act will give explicit legal oversight powers to DNB and AFM (i.e., recommendation 18).

109. Regarding the recommended action on the admission rules of Euroclear Netherlands, these rules are under review in order to broaden access to include non-EEA credit institutions (recommendation 14).

110. With respect to the development of cross-border DVP-links between CSDs (recommendation 19), although not needed to improve observance, the authorities endorse

the view that it is important to support Euroclear initiatives, and that system participants should require such links in order to reduce risk. However, the relevant dimension to solve barriers for cross-border links is European rather than national. In this, the Netherlands is in the same position as a number of other European countries.

FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism

Introduction

111. This Report on the Observance of Standards and Codes for the *FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations for Combating the Financing of Terrorism* was prepared by a team of Fund staff and an expert not under the supervision of Fund staff selected to assess matters concerning criminal law enforcement and non-prudentially regulated financial activities. This report provides a summary of the level of observance with the FATF 40+8 Recommendations, and provides recommendations to enhance observance. The views expressed in this document are those of the assessment team and do not necessarily reflect the views of the government of the Netherlands or the Fund Executive Board.

Information and Methodology used for the Assessment

112. This assessment is based upon a review of the relevant AML/CFT laws and regulations, and supervisory and regulatory systems in place to deter money laundering and financing of terrorism among macro-economically relevant, prudentially regulated financial institutions. In addition, the expert not under the supervision of Fund staff reviewed the capacity and implementation of criminal law enforcement systems and the regulatory systems in place for casinos. The assessment is based primarily on information available at the time it was completed on December 12, 2003.

Main findings

Criminal Justice Measures and International Cooperation

Criminalization of ML and FT

113. The Netherlands has ratified and implemented all international conventions directly relevant for AML/CFT, except for the Palermo Convention which it expects to ratify shortly. A sound structure is in place for implementation of UN Security Council Resolutions relating to FT through domestic law and practice and directly applicable EU regulations.

114. Criminal money laundering (ML) offenses follow the international standards set forth by the Vienna, Strasbourg, and Palermo Conventions. Predicate offenses are all offenses penalized with a maximum of six months imprisonment or more. Self-laundering is covered, and there is liability for legal persons. ML and financing of terrorism (FT) offenses apply to

persons who knowingly engage in prohibited activities. For some ML offenses, a reasonable suspicion standard also applies. Recent criminal ML provisions should be evaluated based upon case outcomes to ensure standards of proof required by the courts are not undermining effective use of the provisions. Whether foreign crimes may serve as predicate offenses is not explicit in legal provisions and has not been tested, but a legislative explanation for the previous criminal ML provisions provides support for foreign offense coverage. Penalties for ML are quite low and should be reviewed.

115. FT is criminalized primarily through participation in a criminal organization and preparation offenses with amendments made or in process that ensure comprehensive coverage. An explicit provision that support to a terrorist organization or its members constitutes participation, a concept already implicit in legal provisions, is expected soon.

Confiscation of proceeds

116. Confiscation is addressed through both property and value based provisions, and applies to economic benefits from any criminal offense. Although regularly imposed, it is not mandatory. Proceeds from conduct other than the offense of conviction may be confiscated. Specific provisions address protection of bona fide third parties and recent amendments ensure that assets an offender transfers to third party legal entities may be confiscated.

117. Laws provide for provisional measures including the freezing of funds of terrorists and those who finance terrorism. Thus far, assets have been frozen quickly through judicial orders, and freezing powers for the financial intelligence unit (FIU) have not been needed. Refinements to the powers to identify and trace and to secure customer identification orders should be made as planned. Authorities may share confiscated assets with jurisdictions requesting confiscation assistance. Sharing possibilities should be considered for domestic cases where foreign authorities have assisted.

118. *Although statistics are maintained, they are not sufficient to assess fully the effectiveness of the AML/CFT regime because of the lack of data by offense type. Training is available for police and prosecutors but is not mandatory and seems limited.*

FIU and processes for receiving, analyzing, and disseminating suspicious reports

119. MOT, an administrative body within the Ministry of Justice that serves as the Dutch FIU, receives, analyzes and disseminates ML and FT-related disclosures. It has access to a wide range of public and non-public databases and has full powers to require additional information needed to assess reports.

120. MOT may share all information with police authorities, and general information, but not specifics such as reports, with supervisory authorities. Legislative changes are expected in 2004 to permit enhanced sharing with supervisory authorities. MOT may share information with foreign FIUs and does so on a regular basis.

121. *MOT keeps statistics on most relevant data and breaks it down into a number of categories to enhance its relevance, but neither MOT nor others track the number of STRs/UTRs that result in investigations or prosecutions. MOT appears to be adequately funded, and its high level of automation and efficiency has helped it to address dramatic increases in STR/UTR numbers, but the assignment of additional investigators should be considered.*

Law enforcement and prosecution authorities, powers, and duties

122. The FIU and other law enforcement authorities have adequate powers to require production of records, and investigative techniques are available as needed. *AML/CFT resources and expertise are spread over multiple regional and national bodies leading to resource allocation and structural inefficiency issues. Further consolidation of resources within national police and prosecutorial units, policy control at the national level and dedicated regional resources answerable to national units should be considered. Additional prosecutorial resources at the national level for confiscation matters and ML investigations is advisable. Removal of the Parliamentary prohibition on the use of criminal-civilian informants in Dutch investigations would greatly enhance Netherlands' ability to investigate ML organizations.*

International Cooperation

123. The Netherlands has a fairly comprehensive set of bilateral and multilateral treaties that provide for mutual legal assistance and extradition in ML and FT matters. Mutual legal assistance is available for both negligent and intentional conduct, and when the investigation or proceeding relates to a predicate offense and ML, and to ML alone. Without a treaty, assistance is limited to specified measures not requiring coercion. As suggested in the 1998 FATF mutual evaluation report, authorities might consider legislation that would permit a wider range of assistance in the absence of a treaty.

124. Dutch laws and procedures generally permit the recognition of foreign confiscation and forfeiture judgments but there has been little practical experience. Under recent legislation, enforcement should be available for non-conviction based foreign forfeiture orders. Authorities should monitor the effectiveness in practice of current laws in permitting recognition and enforcement as foreign orders are presented.

125. *The Netherlands provides timely and effective follow-up to mutual legal assistance requests and maintains an extensive database system for the requests which authorities plan to update to include predicate offense information. However, the assistance the Netherlands provides in confiscation matters, particularly for non-conviction based forfeiture, has had mixed results. The Netherlands protects itself from providing safe haven for terrorists through new immigration laws, extradition procedures and the ability to prosecute persons located in the Netherlands for acts of terror committed abroad.*

Preventive Measures for Financial Institutions (FI)

126. A highly developed set of laws and regulations address preventive measures, and these measures are adjusted and updated regularly. A merger of the Identification of Services Act (ISA) and Disclosure of Unusual Transactions Act (DUTA) with an updating of provisions, as is currently under consideration, would provide a more efficient framework for AML/CFT. Other changes to supplement the otherwise quite comprehensive framework include enhancing possibilities for imposing administrative sanctions by an ability to impose fines specifically for non-compliance with DUTA or ISA. Adjustments should be made to ensure that MOT can share additional information with supervisors and that supervisors can share more effectively with law enforcement.

127. In addition, rather than relying in some instances on general provisions in regulations on organization and control for specific duties relating to ongoing training, internal audit and reporting procedures, specific requirements should be put in place. There should be explicit requirements that institutions maintain post-account opening materials as well as records regarding matters considered for reporting but not reported. Finally, there should be an enhanced tipping-off provision and, at least within the SR VII timeframe, a formal requirement for comprehensive information to accompany wire transfers. The Netherlands is addressing many of these issues, with legislative and regulatory changes occurring post-mission.

Prudentially Regulated Sectors

128. Oversight responsibility for compliance with AML/CFT laws and regulations by regulated financial institutions lies with the financial sector regulators. These are the DNB for credit institutions, the PVK for insurance companies and pension funds and the AFM for securities and investment firms. The regulators have all developed risk analysis tools which, among other things, cover the management of risk associated with AML/CFT. These tools are designed to provide the regulators with an early picture of institutions' internal risk management and control environments and highlight areas in need of attention. On the basis of these assessments, the regulators plan their supervisory programs which may include on-site visits. Of the three regulators, the DNB has developed the most robust program to provide guidance to financial institutions and assesses compliance.

129. In June 2002, the DNB in conjunction with the bankers association issued the Basle Committee CDD paper to credit institutions indicating that they should observe standards set out in the paper. Credit institutions were subsequently asked to benchmark their current practices against the requirements of the paper and determine where gaps existed. In May 2003, the DNB took the further step of issuing an explanatory memorandum on the CDD paper. The majority of the banks have undertaken the gap analysis. DNB is still in the process of reviewing the results of the analysis and will at a later stage develop CDD risk profiles of credit institutions.

130. In contrast to the approach adopted by the DNB, at the time of the assessment the PVK and AFM had not issued guidance to institutions for which they have regulatory responsibility. However this changed in part, as on January 1, 2004 regulations were issued under Decree on Integrity (issued December 1, 2003), giving effect to the Act on Actualization and Harmonization of Supervision. The new regulations include the guidance of the Basle CDD paper and are applicable to the financial institutions regulated by the PVK and the AFM. Further, by April 2004 there will be a merger of the DNB and PVK. This merger represents an opportunity for the DNB's more robust approach to AML/CFT compliance to be applied to insurance firms to the extent justified by the risk inherent in their business activity.

131. While the DNB has issued the CDD paper as its principal form of AML/CFT guidance, the paper was not designed as a comprehensive guidance note. As a result there are certain gaps in the guidance that has been provided.

132. The insurance and securities sectors are considered to have a relatively low vulnerability to ML and FT. However the perception within the industry appears to be that there is no vulnerability at all. This, in all likelihood, is in part responsible for the very low rate of reporting of UTRs.

133. While fit and proper test for members of the supervisory and executive boards of all financial institutions are undertaken by the DNB, PVK and AFM, DNB has delegated this supervision to the central organization of a cooperative bank (besides this supervising role of the central organization, DNB visits member banks). In undertaking this task the regulators have indirect access to information held by the national public prosecutor responsible for AML/CFT. In case of this one cooperative bank the central organization of the banks does not have similar access, and its fit and proper test is therefore not as robust as those undertaken by the regulators.

134. While bearer shares are not generally used in the Netherlands, they can be issued by Dutch companies. A DNB circular of June 2001 which deals with bearer shares relates to instances in which a bank is actually handling the shares. It does not provide guidance to institutions for dealing with corporate customers that issue such shares. The only other guidance in this regard comes from CDD which advises that extra care is required in dealing with entities that issue bearer shares. This recommendation is very general and does not offer much in the way of guidance on this subject.

Non-Prudentially Regulated, Macrorelevant Sectors

135. Trusts, as known to many common law countries, are not generally used in the Netherlands. The term "trust" as used in the Netherlands usually refers to a person who provides company management services. The Netherlands is in the process of implementing a regime for the regulation of this activity. Under legislation which came into force in March 2004, trust offices will be required to have up-to-date information on the ultimate beneficial ownership of all entities under management and the purchaser of any entity being sold. The

records must also show that the trust office has knowledge of (a) the source and destination of funds of the object company; (b) the relevant parts of the group structure; and (c) the objective for which the structure was set up. If the trust office itself acts as a trustee, it must know who the settlor of the trust is.

136. *Casinos are tightly monitored for ML and file STRs/UTRs on a regular basis. The risk that casinos will serve as an entry point for criminal proceeds is low, because a government run casino monopoly lowers the risk of casino corruption, all gamblers are fully identified and registered in the casino database and only winnings may be converted into non-cash forms and be declared as a legitimate source of income.*

Summary assessment against the FATF recommendations

137. The Netherlands complies well with most of the assessable FATF 40+8 Recommendations. Areas requiring attention are highlighted in the following table. In addition, in areas where the Netherlands meets the appropriate standard, Table 8 sets forth technical and general suggestions to further strengthen the framework.

Table 8. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Reference FATF Recommendation	Recommended Action
40 Recommendations for AML	
General framework of the Recommendations (FATF 1-3)	As planned, ensure MOT is able to share specific information with supervisors, in addition to the general information that already may be shared.
Provisional measures and confiscation (FATF 7)	Make confiscation of criminal proceeds for ML/FT mandatory.
Customer identification and record-keeping rules (FATF 10-13)	Address more specifically as planned a requirement that there be renewal of identity if in the course of a business relationship doubts occur regarding the identity of a client. Incorporate specific recordkeeping requirements for account relationship materials (post account opening) and transaction records as authorities adopt revisions to ISA/DUTA. DNB should provide more specific guidance to licensees on measures that should be adopted to minimize the risk inherent in dealing with bearer shares.
Increased diligence of financial institutions (FATF 14-19)	As is occurring, introduce an explicit requirement for internal procedures regarding ongoing training, and amend laws/regulations to address an internal audit function for any sector for which it is not explicit. Amend laws/regulations to require management level compliance officers. Expand scope of tipping off prohibition to cover those who come into contact with information regarding the reporting or consideration of a decision to report. Ensure in all sectors that institutions are required to maintain records of transactions considered for reporting but not reported and that these records are available for supervisory review.

Reference FATF Recommendation	Recommended Action
Implementation & role of regulatory and other administrative authorities (FATF 26-29)	Extend integrity testing by supervisors in practice to a wider range of senior management outside of the Executive Board. Rectify the deficiency identified in the role played by the central organization of the cooperative bank in undertaking fit and proper examinations.
8 Special recommendations on terrorist financing	
VII. Wire transfers	Within the two-year period referred to by FATF, amend relevant laws to require that accurate and meaningful originator information (name, address and account number) on funds transfers remain with the transfer throughout the payment chain. Impose an obligation, consistent with SR VII, on FSPs to give enhanced scrutiny to wire transfers that do not contain complete originator information and provide guidance that encourages compliance on an immediate basis.
VIII. Non-profit organizations	The direction given to financial institutions in respect of their dealings with non-profit organizations should be expanded. The working group on non-profits in the Netherlands should come up with reasonable measures to improve the transparency and monitoring of foundations and associations in general as well as with measures to improve the registration, regulation and monitoring of charities.

138. Other recommendations not directly related to compliance with the FATF 40+8 appear in the detailed assessment report.

Authorities' responses

139. The authorities had the following general comments:

- First of all, the Netherlands wishes to thank the members of the IMF assessment team for all the work that had to be done to produce this fair and balanced report. Many of the recommendations made by the assessment team will be implemented as planned in the course of a revision of the two most important AML laws (DUTA and ISA). Other recommendations have already been implemented since the mission was completed. This relates to new integrity regulations for the banking and insurance sector.

- It is worth mentioning that since the mission has been completed the Dutch government announced a set of measures to enhance the fight against money laundering and terrorist financing in a letter to Parliament in April 2004. Measures consist a.o. of the merger of MOT and BLOM, the promulgation of a directive on money laundering prosecutions for the public prosecution service and close cooperation of the fiscal investigation service (FIOD-ECD) and the National Investigation Service (Nationale Recherche) in complex money laundering cases. These last two measures have also been taken following such recommendation by the assessors to centralize and coordinate the fight against money laundering and terrorist financing on a more national level.

140. In connection with the recommended Action Plan to Improve Compliance with the FATF recommendations, the authorities had the following specific comments:

- As far as the "Recommended Action Plan to Improve Compliance with the FATF recommendations" (Table 8) is concerned, we welcome the support of the assessment team for the change in the Disclosure of Unusual Transaction Act (DUTA) that will enable the MOT (FIU) to share specific information with supervisors.

- The recommendation to make the confiscation of criminal proceeds for ML/FT cases mandatory affects the autonomy and discretion of the public prosecution service in criminal proceedings, one of the central pillars of the criminal justice system in the Netherlands. The public prosecution service decides on a case by case basis whether the confiscation of criminal proceeds is possible and likely to be effective in comparison to other financial settlement modalities, such as tax-fines. Therefore, this recommendation will not be implemented.

- Customer identification and record-keeping rules are of great importance to any AML system. We welcome the support for the planned change in the Identification of Services Act (ISA) which will clarify the requirement of the renewal of identity in the course of a business relationship when doubts appear. This planned change fits well in the planned revision of the ISA, to make it more comprehensive and easier to read. DNB/PVK has, on a post mission basis, issued the "Regulation on CDD for credit institutions and insurers" that also addresses this recommendation.

- The possible misuse of bearer shares is an issue of constant attention to the Netherlands' Authorities. The Authorities wish to emphasize that almost all trade in bearer shares has been dematerialized and that misuse of bearer shares for money laundering purposes has actually never been reported. Meanwhile, DNB will continuously amend guidance whenever necessary.

- In relation to the recommendation of "increased diligence of financial institutions" Authorities would like to stress that with respect to (i) the recommended introduction of an explicit requirement for internal procedures regarding ongoing training; (ii) the recommended amendment of regulations to address an internal audit function; and (iii) the recommended requirement to maintain records of transactions considered for reporting but not reported, DNB/PVK has on a post mission basis issued the "Regulation on CDD for credit institutions and insurers" and the "Regulation preventing the conflict of interest and controlling the integrity risks of insurers." These regulations cover the suggested recommendations. The authorities also plan to address these deficiencies in the revision of ISA and DUTA.

- In relation to the recommendation concerning a compliance officer at management level, the Authorities herewith wish to inform that the "Regulation on organization and control" and the "Regulation preventing the conflict of interest and controlling the integrity risks of insurers," respectively issued by DNB/PVK and applicable for banks and insurers, mention that a compliance officer should be independent from the Board of Directors. The fact that a compliance officer should be independent implies that the compliance officer has a special position in relation to the Board of Directors. We will however further assess your recommendations.

- In the view of the Netherlands, the tipping off prohibition in the DUTA covers anyone who comes into contact with information regarding the (possible) reporting of transactions. However, apparently the provision can be interpreted differently. Therefore we will consider changing the language of this provision in the planned merger of ISA and DUTA in order to clarify the tipping off prohibition as recommended.

- Please be informed that the Netherlands Authorities have taken note of the recommendations concerning the extension of integrity testing by supervisors in practice to a wider range of senior management outside of the Executive Board. Authorities wish to mention the fact that the Netherlands is in the process of amending its financial supervisory legislation (Act on Financial Supervision, due to come into effect in 2005). The recommendations shall be taken into consideration when assessing the scope of persons to be tested on fit and proper requirements, under the provisions of the new Act on Financial Supervision. Furthermore, the Netherlands Authorities wish to state that great value is attached to the supervised responsibility of the financial institutions to prevent being misused by employees by having a comprehensive internal control system. This internal control system must include procedures for internal integrity testing of employees in sensitive positions by the financial institution.

- Full implementation of the 8 special recommendations on terrorist financing is an ongoing process that is considered to be of great importance by the Netherlands Authorities. Implementation of special recommendation VII, as recommended by the assessment team, is one of the main targets for the current Netherlands EU Presidency.

- The Netherlands Authorities thank the assessment team for their recommendations concerning non-profit organizations, which they endorse.

141. With respect to other recommendations, the authorities also made the following points:

- The Netherlands will ratify the Palermo Convention as soon as possible. The ratification has been sent to Parliament, adoption is expected very soon.

- The Netherlands Authorities are of the opinion that it would not be necessary to make it explicit in the written text of the Dutch law that foreign crimes may serve as predicate offences. First, there is legal reference that endorses the coverage of foreign crimes to serve as predicate offences, second in practice, there are no problems with respect to this point.

- The Acts of Terrorism Act, which a.o. makes it explicit that provision of monetary support to terrorists organisations constitutes participation in the terrorist organization, has been adopted by Parliament in June 2004 (Law of 24 June 2004, Stb. 2004/290) and will enter into force on September 1, 2004.

- Since the mission has taken place, the recommended evaluation of the new criminalization of money laundering has already been undertaken in the form of a quick scan, jointly by the Ministry of Justice and the Public Prosecutor for AML/CFT after the mission has taken place. The preliminary results show that close to 80 percent of prosecutions are successful in first instance, indicating that most judges accept the wide scope of the provision, as indented by the legislator.

- The maximum penalties in the Netherlands for various money laundering offences meet international standards and are in line with (for example) the EU Council Framework Decision on ML. In comparison to the penalties for other crimes, the penalties for money laundering offences already by their current level reflect the serious nature of these crimes. Therefore, the Netherlands Authorities see at present no reason for increasing the penalties for money laundering offences.

- The Netherlands Authorities endorse the recommendation to enact border currency reporting requirements. However, within the border free Schengen Area and/or the European Union, any national border currency reporting requirement just for the Netherlands would be primarily symbolical and is therefore only second best. That is why an EU regulation on border currency reporting requirements is an important aim of the current Netherlands EU Presidency. If however a regulation on so-called cash couriers will be unattainable within an EU-framework in the foreseeable future, the Netherlands will consider new legislation in the area of border currency reporting requirements, as a second best solution to an EU regulation.

- Asset sharing can take place with foreign authorities on the basis of legal instruments in place for foreign MLA requests for seizure or foreign confiscation orders. The introduction of asset sharing with foreign authorities who would have assisted otherwise during investigations is not envisaged. International confiscation procedures as well as asset sharing are not very common in MLA practice in continental Europe, which explains the relatively low number of requests and cases. However, the upcoming EU Council Framework Decision on the mutual recognition of confiscation orders will provide for mutual recognition of confiscation orders (i.e., direct enforcement) and an explicit basis for asset sharing. Subsequently a wider use of instruments is expected. Monitoring, if any, should therefore be concentrated on these upcoming changes.

- The Act on powers to trace and identify Financial Records (implementing the Protocol to the EU MLA convention) has entered into force on June 1, 2004.

- Authorities will consider whether the inclusion of offence type references in asset forfeiture statistics and improved tracking of non-article 36 confiscations is technically and practically possible and if the added value of having offence type reference included in asset forfeiture statistics and improved tracking outweigh the costs of having this implemented.

- With respect to the recommendation to make training on forfeiture, money laundering and financing of terrorism mandatory for all public prosecutors and police officers, the Authorities wish to stress that a basic level of financial investigation training is already mandatory for all police investigators. As far as follow-up courses are concerned, a "one size fits all" solution is rejected. Except for basic training, training and education is based on needs for accomplishing functions. For example, all 19 regional public prosecutors offices have appointed specialized public prosecutors for confiscation, prosecutors that have been individually trained for their job.

- The Netherlands is not aware of the existence of any problems, neither structural nor incidental, arising from a possible lack of power for the FIU to order immediate immobilization of assets based on the declaration of unusual transactions. The national public prosecutor on money laundering attached to BLOM ("the police FIU") is duly equipped to respond swiftly to any needs relating to freezing of assets that may arise from a reported unusual transaction. However, Authorities agree that, if ever structural problems should arise in immobilizing assets quickly, the recommended solution may be considerd.

- The current inability to comprehensively track the number of UTRs and STRs that result in investigations or prosecutions is of concern to the Authorities. Improvements in this area should however be placed in the broader context of improvement and harmonization of the registration of investigative information as well as the IT-systems of the police services in general.

- Both MOT and BLOM have recently been assigned more personnel. At present there are no indications that more investigators or non-investigative staff is needed.

- The use of criminal-civilian informants in Dutch investigations is not prohibited. In fact, criminal informants are often used in Dutch investigations. However, the use of criminal civilian infiltrators *is* prohibited in the Netherlands. The Dutch Authorities would like to stress that the prohibition for the use of criminal civilian infiltrators only concerns (long term/deep cover) infiltration actions by criminal civilians, taking part in the criminal activities. So the prohibition does not concern for example using criminals in sting operations or buy/sell actions (because short term), nor does it prohibit using criminals for all kinds of active information gathering in general for which they do not specifically have to commit criminal offences.

- As recommended, financing of terrorism cases are already dealt with in the ‘centralized model’ jointly by the LP (National Prosecutors Office) and the FP (Functional Prosecutors Office). With respect to the assessors’ recommendation to centralize money laundering *investigations*, the government has in its letter to Parliament of May 2004 on enhancing the fight against money laundering emphasized the need to deal with money laundering cases on all different levels of investigation. The Netherlands however endorses the recommendation, as far as it concerns the determination of money laundering *policies*. An example of this is the post-mission promulgation of an instruction on money laundering prosecutions for the public prosecution service by the Board of Procurers-Generals.

- The recommendation that mutual legal assistance should in the absence of a treaty be possible on a discretionary basis with an assurance of reciprocity MLA is endorsed by the Authorities, as this is already possible. In the Netherlands, only requests requiring coercive measures need to be treaty based.

- Authorities agree that the enactment of the new Act on Financial Supervision should lay down clear lines of responsibility and that this should be communicated to all industry participants.

- Authorities welcome the recommendation to go ahead with a merger of ISA and DUTA and to introduce administrative sanctions for violations of DUTA and ISA. The forthcoming amendment of DUTA and ISA will include such administrative sanctions.

- DNB/PVK is currently, in conjunction with the bankers association and the insurers association, developing more detailed and comprehensive AML/CFT guidance.

- With respect to the suggested recommendation regarding the benchmarking of insurers´ practices against the relevant provisions of the CDD paper, please be informed that DNB/PVK is taking into consideration how to most effectively implement the mentioned recommendation.

- DUTA and the Regulation on CDD, applicable for credit institutions and insurers, together cover the mentioned recommendation concerning that institutions should have procedures in place for reporting transactions and that these procedures should be communicate to all personnel.

STRESS TESTING SHOCKS AND SCENARIOS

142. Stress tests were performed to assess sensitivity to various exceptional but plausible macroeconomic shocks. The main tests were carried out by major financial institutions, based on methodologies and scenarios agreed between the authorities and the FSAP team. For these main tests, the institutions covered about 84 percent of total bank assets, 54 percent of insurance company assets, and 50 percent of pension fund assets at end-2002. Tests were of two forms: single factor sensitivity tests, and multi-variable scenarios designed to simulate internally consistent movements in the relevant macro variables. The main shocks tested were:

A. Single-Factor Shocks

	Banks	Insurance companies and pension funds
Horizon	10-day	1 year
Interest rate	• +/- 100 bps parallel shift in yield curves • 50 bps steepening/flattening of yield curves	• +/- 200 bps parallel shift in yield curves • +/- 100 bps parallel shift in yield curves • estimated changes in the redemption yield
Exchange rate	• +/- 10 percent change in Euro vis-à-vis other currencies	• -45 and -30 percent change in Euro vis-à-vis other currencies
Equity	• +/- 15 percent change in all relevant stock indices	• -40 and -25 percent change in developed country equities • -50 and -30 percent change in developing country equities and in private equity
Credit	• +/- 50 bps change in credit spreads	• 60 and 40 percent change in credit spreads for speculative grade credits • 50 and 30 percent change in credit spreads for investment grade credits
Volatility	• 25 percent increase in volatilities related to interest and exchange rates and equity	• 25 percent increase in volatilities for exchange rates, interest rates, credit spreads, equities and commodities

Other risks	None	• -45 and -30 percent change in commodity prices • -20 and -10 percent change in real estate prices • 50 percent increase in worst technical insurance result in last 5 years deterioration in insurance • 50 percent increase in maximum cost in last 5 years.

B. Scenarios

For banks:
Scenario 1. Domestic crisis of confidence
A series of corporate scandals trigger a domestic crisis of confidence. Dutch stock prices slump instantaneously by 45 percent and credit spreads on Dutch corporations increase by 200 bps. As a result of the corporate crisis, unemployment suddenly rises and consumer confidence collapses. Property prices in the Netherlands come under severe pressure. For two years, property prices in the Netherlands fall by 5 percent per quarter to a level 40 percent lower, while commercial property prices fall in the first year by 5 percent per quarter. Due to the higher cost of capital, rising unemployment, and negative effects on confidence and wealth, domestic investment and consumption slowdown. It is assumed there is no policy response by the ECB to these shocks and there are no shocks from abroad.

Scenario 2. Dollar crisis
Due to a sudden turnaround in investor confidence, the U.S. dollar depreciates instantaneously by 30 percent vis-à-vis the Euro and U.S. equity prices fall by 45 percent. The Euro appreciates by 30 percent vis-à-vis all other currencies (which follow the dollar). These shocks cause a slowdown in the U.S. (and global economy), as well as a 20 percent fall in U.S. residential prices over 1 year. Given no changes in ECB policy, financial conditions in the euro area tighten, which together with weaker global economic conditions result in lower exports for the Netherlands and lower GDP growth.

For insurance companies and pension funds:
Single-factor shocks as above occur simultaneously, with correlation 0, 0.5 and 1.

Indicators for the Financial Sector

Table 9. Netherlands: Financial System Structure (1998–2003)

	1998	1999	2000	2001	2002	2003
Number						
Banks	67	61	60	58	59	57
LCFIs 1/	5	5	5	5	5	5
Others	38	33	29	26	28	29
Foreign-owned subsidiaries	24	23	26	27	26	23
Branches of foreign banks	20	25	28	27	29	28
Securities companies	...	...	282	275	255	608
Life insurance companies	105	101	94	93	88	...
General insurance companies	302	301	274	262	249	...
Pension funds	950	925	901	860	762	...
Employees			(in thousands)			
Banks	227.5	233.9	247.2	248.9	245.1	...
LCFIs 1/	215.8	224.0	235.6	237.0	233.2	...
Others	9.6	7.6	8.8	8.2	8.6	...
Foreign-owned subsidiaries	2.1	2.3	2.8	3.7	3.4	...
Branches of foreign banks	0.2	0.2	0.2	0.2	0.2	...
Securities companies	6.3	7.3	7.4	6.6	7.0	...
Life insurance companies	7.7	7.8	8.8	9.4	...	...
General insurance companies	39.5	38.9	38.6	38.1	...	...
Concentration						
Banks 2/	70.7	69.1	68.6	70.3	70.7	69.1
Life insurance companies 3/	...	...	69.8	71.0	69.1	...
General insurance companies 3/	...	...	50.5	49.7	49.8	...
Insurance companies 4/	20	20	19	19	18	
Pension funds 4/	23	22	24	25	25	...
Assets			(in billions of Euro)			
Banks 5/	1,183	1,343	1,573	1,720	1,734	1,850
LCFIs 1/	1,015	1,167	1,383	1,508	1,509	1,655
Others	140	142	154	172	187	195
Foreign-owned subsidiaries	27	33	36	39	38	33
Branches of foreign banks	23	24	33	30	28	28
Insurance companies	215	244	250	297	284	293
Pension funds	366	436	445	466	435	489
Collective investment schemes	75	104	123	114	91	99
Domestic Deposits 6/						
Banks	359	386	419	484	495	528
LCFIs 1/	290	323	354	416	420	465
Others	13	12	12	15	13	12
Foreign-owned subsidiaries	56	51	53	54	61	51
Branches of foreign banks	5	6	6	6	7	6
Memo items:						
Assets in LCFIs 7/	77.1	78.3	78.0	79.3	78.9	80.6
Deposits in LCFIs 7/	80.9	83.7	84.4	85.9	85.0	88.1

Source: DNB, PVK, AFM

1/ ABN Amro Holding, ING Bank, Rabobank Nederland, Fortis Bank Nederland, SNS Bank Nederland.

2/ Percentage of total assets for the three largest institutions.

3/ Percentage of gross premiums earned for the six largest institutions.

4/ Fewest number of institutions with 75 percent of assets.

5/ Based on the consolidated balance sheets of these institutions

6/ Excludes foreign deposits. Although it seems to have stabilized more recently, the proportion of bank funding in the form of deposits has declined over the 1990s from over 60 percent to the low 40 percent range, with debt instruments and other liabilities growing in importance.

7/ As a percentage of total domestic assets or deposits.

Table 10. Netherlands: Domestic Banking System Asset Composition, 1998–2003 1/
(in billions of euros and percent)

	1998	1999	2000	2001	2002	2003
Total assets	**896.2**	**983.7**	**1,148.9**	**1,265.9**	**1,356.4**	**1,469.0**
Distribution of assets						
Claims by residency						
Total claims on EU residents	83.5	84.3	84.7	81.1	82.0	83.4
Total claims on Non-EU residents	16.5	15.7	15.3	18.9	18.0	16.6
Claims on EU residents by instrument 2/						
Loans	66.5	67.7	68.9	65.8	65.7	66.8
Securities other than shares	10.7	10.0	8.6	8.1	9.6	9.8
Shares/other equity	2.8	2.5	3.2	3.3	2.7	2.5
Claims on EU residents by sector 2/						
MFIs	23.1	23.3	26.2	25.0	25.1	26.2
Government	16.3	13.9	11.6	10.8	10.6	11.0
Others	60.7	62.8	62.2	64.2	64.3	62.8
Total private sector loans to EU residents 3/	**415.2**	**473.3**	**543.3**	**587.6**	**629.3**	**676.8**
Distribution of loans						
Clains by sector						
Households	46.3	47.2	49.5	50.2	50.2	51.0
Mortgages	39.0	40.3	42.8	44.2	44.1	44.7
Other	7.2	6.9	6.8	6.0	6.1	6.4
Insurance and pension Funds	1.2	1.0	1.0	1.3	1.4	1.0
Other non-bank financial intermediaries	10.9	12.1	11.9	12.2	14.1	15.9
Non-financial private corporations	31.5	30.6	29.2	28.1	25.5	23.9
Non-financial public corporations	10.1	9.1	8.4	8.2	8.7	8.2
Total claims on nonresidents	**243.2**	**279.5**	**311.4**	**392.9**	**411.0**	**446.0**
Geographical distribution of claims						
European Union	67.2	70.0	72.3	69.0	74.0	76.0
of which: Germany	11.9	11.2	12.3	9.5	11.5	12.8
UK	24.6	22.6	26.1	28.7	31.9	29.6
Asia	9.7	7.0	4.4	8.0	5.5	4.9
of which: Japan	6.3	3.4	2.1	5.7	3.2	2.7
Americas	16.0	16.2	16.0	17.3	15.4	13.2
of which: United States	11.5	9.9	9.8	11.7	10.7	9.2
Eastern Europe	1.0	1.3	1.1	1.1	0.9	1.5
Others	6.1	5.5	6.1	4.6	4.2	4.3
Sectoral distribution of claims						
Banks	67.4	62.9	63.0	66.7	63.6	63.6
Nonbanks	32.6	37.1	37.0	33.3	36.4	36.4
Memo items:						
Loans to non-EU area residents	17.1	16.3	15.8	19.8	19.0	17.5
Foreign currency loans to total loans	17.2	16.5	16.6	20.3	17.0	15.4
Residential real estate loans to total loans 4/	49.4	45.4	43.6	44.2	45.3	48.3
Large exposures to tier-1 capital	0.78	1.13	1.14	1.21	0.75	0.77

Source: DNB

1/ Based on the balance sheets of MFIs in the Netherlands.

2/ Data only available for EU area residents.

3/ Excludes lending to governments and banks.

4/ Based on domestic loans.

Table 11. Netherlands: Domestic Banking System Off-Balance Sheet Positions, 1998–2003 1/
(in billions of U.S. dollar unless noted otherwise)

	1998	1999	2000	2001	2002	2003
Total notional value of derivative contracts	3,572	4,651	4,692	5,274	6,614	8,701
Gross positive market value	63	62	70	76	133	161
Gross negative market value	62	56	68	87	145	161
Total net market value	1	5	2	-11	-12	0
of which						
Foreign exchange contracts	1,296	1,113	1,194	1,295	1,442	1,652
Gross positive market value		26	33	26	32	51
Gross negative market value		23	33	22	35	52
Interest rate rate contracts	2,217	3,486	3,437	3,912	5,120	6,989
Gross positive market value		33	35	46	98	107
Gross negative market value		30	32	62	107	108
Equity contracts	60	52	61	67	52	60
Gross positive market value		2	2	3	4	3
Gross negative market value		4	3	3	3	1
Other commodity contracts	…	…	…	…	…	…
Gross positive market value	…	…	…	…	…	…
Gross negative market value	…	…	…	…	…	…
Total notional value of exchange traded contracts	2,897	4,591	5,167	6,374	6,445	716
of which						
Interest rate rate contracts	1,865	3,432	3,849	4,886	5,052	645
Foreign exchange contracts	936	1,057	1,194	1,368	1,263	9
				0		0
Other commodity contracts	2	1	2	5	8	9
Equity contracts	38	39	51	45	37	53
Memo items:						
Credit derivatives	…	…	…	57.0	…	…
Contigent liabilities (EUR billions)	64	84	90	89	89	75
Irrevocable facilities (EUR billions)	162	212	264	267	257	245

Source: DNB

1/ Based on the balance sheets of the three largest banks. Data does not cover all derivative contracts, for e.g., credit derivatives

Table 12. Netherlands: Major Institutional Investors' Asset Composition, 1998–2003
(in billions of euros, and percent)

	1998	1999	2000	2001	2002	2003
Total assets	**581.1**	**680.2**	**694.9**	**763.1**	**719.2**	**782.5**
Insurance corporations	215.4	243.9	250.0	297.0	284.3	293.2
Pension funds	365.7	436.3	444.9	466.1	434.9	489.2
Distribution of assets by type						
Insurance coporations						
Non-mortgage loans	19.0	16.3	15.1	14.8	13.9	12.1
Mortgages	11.5	11.4	12.0	12.7	15.6	11.5
Securities other than shares	32.2	31.4	31.9	24.6	25.0	30.0
Shares	28.8	32.4	31.5	32.4	28.1	28.9
Others	8.5	8.5	9.6	15.4	17.4	17.5
Pension Funds						
Non-mortgage loans	15.6	10.0	7.5	6.2	5.0	3.4
Mortgages	3.0	2.5	2.6	2.1	2.4	2.1
Securities other than shares	32.0	29.4	34.4	34.1	40.7	37.2
Shares	41.6	51.6	49.0	48.3	42.3	46.3
Others	7.9	6.5	6.5	9.3	9.5	11.0
Distribution of assets by sector						
Insurance coporations & pension funds						
Residents	67.1	54.7	50.6	47.0	46.3	41.9
Government	17.8	13.1	11.6	8.8	7.0	5.8
MFIs	11.5	9.4	9.1	7.3	9.0	8.6
Others	37.9	32.2	29.9	30.9	30.2	27.5
Nonresidents	32.9	45.3	49.4	53.0	53.7	58.1
EU	...	...	...	...	24.3	31.9
Others	...	...	...	...	29.4	26.2
Memo items:						
Nonresident shares	18.5	28.8	29.1	30.3	26.3	29.0
Nonresident securities other than shares	12.6	15.3	19.3	21.6	26.5	27.6

Source: DNB

Table 13. Netherlands: Domestic Banks' Profitability and Liquidity 1/
(in percent)

	1998	1999	2000	2001	2002	2003
Earnings and Profitability						
Return on assets (pre-tax)						
LCFIs	0.60	0.80	0.79	0.55	0.47	0.63
Other banks	0.59	0.57	0.82	0.53	0.52	0.50
Foreign subs	1.07	1.24	1.60	1.07	-0.43	0.69
Return on equity (pre-tax)						
LCFIs	15.16	20.37	19.58	14.34	12.76	16.93
Other banks	14.79	14.14	19.98	12.96	13.21	12.64
Foreign subs	18.60	19.93	25.39	15.78	-6.03	10.06
Interest margin to gross income						
LCFIs	0.60	0.58	0.52	0.55	0.60	0.60
Other banks	0.63	0.63	0.55	0.66	0.65	0.64
Foreign subs	0.51	0.52	0.49	0.52	0.61	0.83
Trading income to total income						
LCFIs	0.07	0.08	0.09	0.08	0.06	0.07
Other banks	0.06	0.06	0.05	0.05	0.09	0.04
Foreign subs	0.10	0.09	0.12	0.07	0.01	0.06
Noninterest expense to gross income						
LCFIs	0.81	0.75	0.76	0.80	0.82	0.76
Other banks	0.59	0.56	0.52	0.61	0.63	0.60
Foreign subs	0.73	0.68	0.62	0.78	0.94	0.65
Personnel expenses to noninterest expenses						
LCFIs	0.50	0.53	0.53	0.53	0.50	0.51
Other banks	0.49	0.49	0.50	0.51	0.47	0.47
Foreign subs	0.45	0.48	0.52	0.48	0.47	0.44
Spread between average lending and deposit rates						
Average	3.40	0.72	1.90	1.90	1.19	0.51
Liquidity						
Liquid assets to total assets 2/						
LCFIs	26.7	25.3	25.5	26.2	26.2	26.2
Other banks	12.5	13.9	13.1	14.8	13.3	15.0
Foreign subs	24.5	26.2	23.2	23.0	16.5	28.1
Liquid assets to short-term liabilities 3/						
LCFIs	56.0	52.7	53.7	53.6	52.6	52.1
Other banks	38.6	44.9	44.0	51.3	45.9	59.9
Foreign subs	50.7	61.6	64.7	55.5	42.8	59.7
Liquid assets to loans 4/						
LCFIs	48.6	42.6	42.8	44.7	44.4	46.0
Other banks	18.6	20.8	21.5	24.0	20.0	22.9
Foreign subs	45.3	50.6	44.9	49.3	29.2	73.7

Source: DNB and IFS

1/ Based on consolidated balance sheets of Dutch banks.

2/ Cash and cash equivalents to total assets. Assumes securities and shares are liquid.

3/ Cash and cash equivalents to savings and other funds. Assumes securities and shares are liquid.

4/ Cash and cash equivalents to total loans excluding interbank lending. Assumes securities and shares are liquid.

Table 14. Netherlands: Domestic Banks' Capital Adequacy and Nonperforming Loans 1/
(in percent)

	1998	1999	2000	2001	2002	2003
Capital Adequacy						
Average capital-assets ratio						
LCFIs	3.77	4.06	3.91	3.67	3.69	3.82
Other banks	4.40	4.44	4.75	4.59	4.48	4.37
Foreign subs	5.16	5.14	5.46	5.44	5.69	6.60
Regulatory capital to risk-weighted assets						
LCFIs	10.80	10.57	10.61	10.75	11.11	11.21
Other banks	16.66	17.95	17.74	17.18	17.21	18.90
Foreign subs	12.56	11.90	12.54	13.46	14.67	18.58
Tier-1 to risk-weighted assets						
LCFIs	7.87	7.80	8.04	7.80	8.22	8.59
Other banks	12.99	13.26	12.99	12.71	12.99	13.49
Foreign subs	13.92	14.77	14.92	14.19	14.34	16.40
Tier-2 to risk-weighted assets						
LCFIs	2.89	2.82	2.86	3.12	3.03	2.93
Other banks	3.16	3.87	3.87	3.84	3.53	3.16
Foreign subs	2.52	2.16	2.71	2.54	2.92	3.11
Tier-3 to risk-weighted assets						
LCFIs	0.16	0.13	0.13	0.09	0.08	0.06
Other banks	0.00	0.00	0.05	0.04	0.00	0.00
Foreign subs	0.02	0.01	0.01	0.00	0.00	0.00
Nonperforming assets						
Nonperforming loans to total gross loans						
3 largest banks	2.5	2.4	2.2	2.3	2.0	...
Other banks	...	...	...	...	...	...
Foreign subs	...	...	...	...	...	...
Nonperforming loans to Tier-1 capital 2/						
3 largest banks	28.0	32.0	31.0	32.0	24.0	...
Other banks	...	...	...	...	...	...
Foreign subs	...	...	...	...	...	...
Loan loss provisions to total gross loans						
LCFIs	0.40	0.24	0.17	0.33	0.42	0.34
Other banks	0.13	0.12	0.12	0.11	0.14	0.12
Foreign subs	0.47	0.29	0.07	0.51	2.48	0.47
Loan loss reserves to total gross loans						
LCFIs	1.56	1.54	1.26	1.28	1.24	1.19
Assets in LCFIs	0.44	0.39	0.48	0.54	0.54	0.59
Deposits in LCFIs	1.44	1.33	1.37	1.56	3.88	5.29

Source: DNB

1/ Based on consolidated balance sheets of Dutch banks.

2/ Net of loan loss reserves.

Table 15. Netherlands: Domestic Life Insurer's Profitability and Liquidity 1/
(in percent)

	1998	1999	2000	2001	2002	2003
Life Insurers						
Earnings and Profitability						
Return on assets	1.1	1.3	1.4	1.3	0.2	...
Return on equity	8.3	9.2	12.6	13.4	2.2	...
Earned premiums	18.6	20.4	23.0	25.0	23.1	...
Liquidity						
Cash assets to total assets	0.2	0.1	0.3	0.3	0.7	...
Equity holdings to total assets	16.4	16.8	14.7	13.1	9.7	...
Fixed income holdings to total assets	45.4	41.6	40.7	40.8	44.5	...
Foreign assets to total assets 1/	32.9	45.3	49.4	53.0	53.7	58.1
Capital						
Capital to assets	15.7	14.1	11.6	10.6	9.1	...
Average solvency ratio	440.0	457.0	374.0	304.0	231.0	...
Sponsored Pension Plans (Pillar 2)						
Total number of pension funds	950	925	901	860	797	...
Industry-wide pension funds	88	90	94	98	96	...
Company pension funds	851	824	796	751	690	...
Occupational pension funds	11	11	11	11	11	...
Number of active participants ('000)	4931	5176	5391	5905	6209	...
Number of participants receiving benefits ('000)	1915	1969	2014	2131	2205	...
Annual entitlements (EUR billions)	56.2	69.0	91.2	61.3	53.9	...
Gross benefits	10.5	11.3	13.2	13.3	14.6	...
Gross premiums	9.2	10.1	10.9	12.8	18.5	...
Change in value of investments	42.0	66.7	12.0	-11.5	-34.6	...
of which: unrealized	17.2	36.3	-5.0	-20.7	-47.5	...
Average cover ratio	133	139	132	118	101	...
Standardized cover ratio 2/	142	150	141	127	108	...

Source: DNB and PVK
1/ For all insurance companies. Based on DNB Statistical Bulletin.
2/ Calculated using standardized assumptions on liabilities.

Table 16. Netherlands: Other Financial Soundness Indicators, 1998–2003

	1998	1999	2000	2001	2002	2003
Corporate sector						
Corporate debt to GDP ratio	93.6	101.6	109.5	109.2	112.8	...
Total debt to equity	167.9	164.3	167.6	173.8	...	...
Return on equity	6.6	6.1	6.1	5.4	5.4	4.8
Number of applications for protection from creditors	4015	3238	3579	4430	4963	6386
Households						
Household debt to GDP	79.5	87.2	91.7	95.1	102.1	108.4
Household debt service	9.5	9.8	10.5	10.2	10.3	9.9
Unemployment rate	5.1	4.3	3.7	3.4	4.1	5.4
Mortgage "affordability" index	123.1	115.2	89.3	92.3	92.2	...
Bankruptcies	1011	596	901	1459	1786	2354
Real estate markets						
Residential real estate prices (median prices, EUR '000)	138.9	167.3	187.4	196.9	205.0	...
Commercial real estate prices (median rental prices, EUR '	92.5	96.0	101.7	106.0	109.0	...

Source: DNB and PVK