



KINGDOM OF THE NETHERLANDS—NETHERLANDS

FINANCIAL SECTOR ASSESSMENT PROGRAM

April 2017

TECHNICAL NOTE—SECURITIES SUPERVISION— SELECTED ISSUES REGARDING THE REGULATORS, AUDITOR OVERSIGHT, AND COLLECTIVE INVESTMENT SCHEME MANAGEMENT

This Technical Note on Securities Supervision—Selected Issues Regarding the Regulators, Auditor Oversight, and Collective Investment Scheme Management for 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 April 2017.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS— NETHERLANDS

FINANCIAL SECTOR ASSESSMENT PROGRAM

April 2017

TECHNICAL NOTE

SECURITIES SUPERVISION—SELECTED ISSUES REGARDING
THE REGULATORS, AUDITOR OVERSIGHT, AND
COLLECTIVE INVESTMENT SCHEME MANAGEMENT

Prepared by
**Monetary and Capital Markets
Department**

This Technical Note was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) in the Netherlands. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

CONTENTS

| | |
|--|-----------|
| Glossary | 4 |
| EXECUTIVE SUMMARY | 6 |
| INTRODUCTION | 9 |
| A. Regulatory Structure | 10 |
| REGULATOR ISSUES | 11 |
| A. Independence | 11 |
| B. Legal Protection of Governing Body and Staff | 15 |
| C. Powers | 16 |
| MARKET-BASED FINANCE | 19 |
| A. Crowd Funding | 19 |
| B. Asset-Backed Securities/Securitizations | 21 |
| AUDITOR OVERSIGHT | 24 |
| A. Audit and Auditor Requirements | 25 |
| B. Audit Standards | 29 |
| C. Auditor Oversight | 29 |
| FUND MANAGEMENT | 37 |
| A. Market Structure | 37 |
| B. Regulation | 39 |
| C. Authorization | 55 |
| D. Supervision | 59 |
| E. Systemic Risk Monitoring | 68 |
| BOX | |
| 1. Leverage Calculation Methods | 50 |
| TABLES | |
| 1. Key Recommendations | 8 |
| 2. Crowd-Funding Data, as of September 30, 2016 | 20 |
| 3. Securitizations by Dutch Originators | 23 |
| 4. Foreign Securitizations by Foreign Originators Using Dutch SPVs | 23 |
| 5. Dutch Securitizations by Type of Investor | 24 |
| 6. Number of Statutory Audits | 25 |

| | |
|---|----|
| 7. Regular Inspections Carried Out in the Years 2011–15 | 32 |
| 8. Thematic Inspections Carried Out in the Years 2011–15 | 33 |
| 9. Investigations Carried Out in the Years 2011–15 | 35 |
| 10. Number of Netherlands Domiciled CIS, as of September 2016 | 38 |
| 11. AIFMD: Number of New Licenses and Registrations | 56 |
| 12. Formal Enforcement Actions of the AFM in the Period 2014–15 | 67 |
| 13. Formal Enforcement Actions of the DNB in the Period 2011–15 | 68 |

APPENDICES

| | |
|--|----|
| I. Full Recommendations on Securities Regulation and Supervision | 72 |
| II. Cross-Border Offering of Funds and Fund Management Services | 74 |

Glossary

| | |
|--------|--|
| AFM | Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten) |
| AIF | Alternative Investment Fund |
| AIFMD | Alternative Investment Fund Managers Directive |
| AUM | Assets under Management |
| Awb | General Act on Administrative Rules (Algemene wet bestuursrecht) |
| BGfo | Decree on Conduct of Business Supervision Financial Institutions (Besluit Gedragstoezicht financiële ondernemingen, Wft) |
| Bta | Audit Firms Supervision Decree (Besluit toezicht accountantsorganisaties) |
| DNB | The Dutch Central Bank (De Nederlandsche Bank N.V.) |
| EC | European Commission |
| EEA | European Economic Area |
| EMIR | European Market Infrastructure Regulation |
| EQCR | Engagement Quality-control Review |
| ESMA | European Securities and Markets Authority |
| ESRB | European Systemic Risk Board |
| EU | European Union |
| EuSEF | European Social Entrepreneurship Fund |
| FATF | Financial Action Task Force |
| FSC | Financial Stability Committee |
| IAASB | International Auditing and Assurance Standards Board |
| ICAAP | Internal Capital Adequacy Assessment Program |
| IOSCO | International Organization of Securities Commissions |
| KPRs | Key Points of Review |
| MiFID | Markets in Financial Instruments Directive |
| MMF | Money Market Fund |
| MMoU | IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information |
| MoF | Ministry of Finance |
| MoU | Memorandum of Understanding |
| NAV | Net Asset Value |
| NBA | Netherlands Institute of Chartered Accountants (Koninklijke Nederlandse Beroepsorganisatie van Accountants) |
| NV COS | Further Regulations regarding Audit and other standards (Nadere Voorschriften Controle- en Overige Standaarden) |

| | |
|-------|---|
| PIE | Public Interest Entity (Organisaties van Openbaar Belang) |
| RIP | Risk Identification Project |
| RMP | Risk Mitigation Project |
| SMEs | Small- and Medium-Sized Enterprises |
| SFT | Securities Financing Transactions |
| SPV | Special Purpose Vehicle |
| UCITS | Undertaking for Collective Investment in Transferable Securities |
| VaR | Value-at-Risk |
| VAO | Audit Firms Regulation (Verordening accountantsorganisaties) |
| ViO | Independence Regulation (Verordening inzake onafhankelijkheid) |
| Wbft | Act on funding financial supervision (Wet bekostiging financieel toezicht) |
| Wft | Act on financial supervision (Wet op het financieel toezicht) |
| Wta | Audit Firms Supervision Act (Wet toezicht accountantsorganisaties) |
| Wtfr | Act on the Supervision of Financial Reporting (Wet toezicht financiële verslaggeving) |

EXECUTIVE SUMMARY

The legal regime and the day-to-day supervision activities conducted by the Autoriteit Financiële Markten (AFM) and De Nederlandsche Bank N.V. (DNB) are extensive and consistent with international expectations, but the supervisors' operational independence could be strengthened. While the AFM and the DNB (the supervisors) may carry on their day-to-day activities independently from political and industry intervention, the perception of their independence may be impaired owing to the extensive authority to the Ministry of Finance (MoF) to intervene. The supervisors have the key powers necessary to carry out their responsibilities, but some additional powers and transparency (such as clarifying the causes for the removal of the governing boards of the supervisors) would assist in ensuring they have the flexibility to meet fast-developing issues and foster greater investor confidence in the system.

The approach to the supervision of the small but growing crowd-funding sector strikes a fair balance between enhancing innovation and protecting investors. To ensure the supervisors have sufficient authority to monitor developments and take action where needed, it would be helpful to broaden the supervisory authority of the AFM to ensure it may develop the regulatory regime for loan-based crowd-funding as needed.

The Dutch regime for audits and auditor oversight is consistent with the International Organization of Securities Commissions' (IOSCO) expectations and appears to work well in practice. Audits are conducted by qualified auditors using Dutch auditing standards that largely follow those set by the International Auditing and Assurance Standards Board (IAASB). Independence rules for audit firms and auditors are extensive and exceed the minimums set under the European Union (EU) law in several key areas, such as a strict separation between providing audit and non-audit services to audit clients. The AFM is responsible for the oversight of the audit profession performing statutory audits, and it carries out its responsibilities directly and through arrangements with two professional associations. The effectiveness of the oversight system could be improved by some additional attention being devoted to on-site reviews of the smaller Public Interest Entity (PIE) audit firms and to ensure that the AFM controls the scope and other key details of the reviews conducted by the professional associations. Additional transparency regarding changes of audit firms of PIEs is also warranted.

The overall collective investment scheme (CIS) supervisory regime is comprehensive, however, the ability to supervise the sector could be enhanced, as could the protection of fund assets. The regulatory regime is largely set at the EU level under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive¹ and Alternative Investment Fund Managers Directive²

¹ Directive 2009/65/EC of the European Parliament and of the Council of July 13, 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for UCITS, as amended by Directive 2014/91/EU, on July 23, 2014, OJ 2014, L 257.

² Directive 2011/61/EU of the European Parliament and of the Council of June 8, 2011 on AIF Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010, OJ 2011, L 174 as amended by Directive 2014/65/EU, on May 15, 2014, OJ 2014, L 173.

(AIFMD). The Dutch authorities do not impose many additional requirements, other than where an alternative investment fund (AIF) is sold to retail investors. Independent depositaries are key in protecting CIS assets from the failure of the manager or other parties but related-party depositaries are permitted, subject to the requirements set by the directives. The use of related-party depositaries does raise risks, and these should be studied to determine if additional safeguards (such as stricter rules on cross-ownership or management) should be imposed. The overall regime would also benefit from more resources being applied to on-site examinations of fund managers by both supervisors.

The ability of the supervisors to monitor the CIS industry, both on a routine basis and for stability assessment purposes, would be enhanced by access to better data. The authorities should work to improve the information provided to the European Securities and Markets Authority (ESMA) on the positions of alternative investment funds (AIFs) and ensure the scope of the reporting obligations under the AIFMD is complete. They should also work for enhanced international exchange of information to improve data availability. This is important both for the domestic market and for monitoring the potential systemic risk of cross-border activities, such as those that give rise to exposures to Dutch counterparties. The supervisors are engaged in important work on identifying and monitoring potential systemic risk in fund management, particularly with reference to liquidity and leverage. Most of this work is in its early stages and should be pursued actively. The supervisors' ability to assess risks of AIFs and other investment funds would be enhanced by adopting a globally harmonized method for calculating fund leverage. The work on both issues should also be coordinated with other work being done at the European level and at IOSCO.

Table 1. Netherlands: Key Recommendations

| Recommendations | Timeframe¹ |
|--|------------------------------|
| Regulator | |
| Reduce the perceived threats to the independence of the supervisors by providing additional autonomy over budget and staffing matters and more transparency on the circumstances when the MoF may act. | I |
| Enhance the flexibility of the supervisors to act via legal reform to expand the rule-making authority of the AFM and the DNB; allow the AFM to obtain information from telecom providers and freeze assets; and both supervisors to use external experts to conduct investigations. | NT |
| Market-based finance | |
| Amend the legislation to broaden the supervisory authority of the AFM with regard to loan-based crowd-funding. | NT |
| Auditor oversight | |
| Enhance transparency by requiring prompt public disclosure of auditor/audit firm changes or resignations. | NT |
| Devote more resources to routine on-site reviews of PIE and non-PIE audit firms. | NT |
| Fund management | |
| Work to ensure the significant shareholders of AIFMs are subject to the same assessment of their suitability and financial soundness as apply to the Markets in Financial Instruments Directive (MiFID) firms and UCITS fund managers. | MT |
| Enhance liquidity risk management requirements for UCITS fund managers; consider requiring routine reporting of liquidity data and stress testing results by UCITS managers. | NT |
| Develop a practical approach to measuring investment fund leverage and continue to contribute to international work to harmonize the leverage calculation method. | MT |
| Assess the risks from the use of related depositaries and consider requiring additional safeguards to address these risks. | NT |
| Conduct more on-site examinations of firms and consider conducting some comprehensive examinations. | NT |
| Ensure that all data needed for supervision and systemic risk monitoring is available on a timely basis and strive for enhanced international exchange of information. | NT |
| ¹ I (immediate): within one year; NT (near term): one–three years; MT (medium term): three–five years. | |

INTRODUCTION

1. This note³ reviews the level of implementation of a subset of the IOSCO Objectives and Principles of Securities Regulation (the IOSCO principles) of particular relevance to the jurisdiction and the ongoing discussions on a global level of securities markets and financial stability. The note focuses on three areas: (a) auditors and auditor oversight; (b) the regulation and supervision of collective investment schemes (CIS), fund managers and monitoring potential systemic risks in this sector of the capital markets; and (c) a follow-up of the Regulator Principles issues relating to regulatory resources, authority and independence that were identified in the last Detailed Assessment of Implementation of the IOSCO principles in the Netherlands that took place in 2011 (the 2011 Assessment). A discussion of the oversight of market-based financing, in particular crowd-funding and asset securitization, also took place. In all cases, the Dutch regime was compared to the expectations of the IOSCO principles approved in 2010 and the Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, August 2013 (the Assessment Methodology), supplemented by more recent Standards issued by IOSCO relating to CIS issues and with respect to crowd-funding.

2. The review topics were chosen in consultation with the supervisors to address market segments currently a focus of financial stability discussions at the domestic and international level or that are fundamental building blocks for the delivery of effective regulation. Since the 2008 global financial crisis, a great deal of attention has been brought to bear on the role of nonbanks in financial stability, particularly that of CIS and market-based finance (also known as shadow banking). The review of the Dutch auditor oversight regime was selected, as accurate financial reporting—reinforced by high quality, independent audits that apply internationally accepted auditing standards—underlies all aspects of financial markets and supervision. The reliability and integrity of the financial reporting process is supported by active, independent oversight of auditors. Effective supervision and regulation of financial markets also requires that there be independent, suitably resourced regulators in place that have sufficient powers to take timely actions as market developments demand.

3. The discussion of investment funds focuses on reviewing the effectiveness of the regulation, supervision, and systemic risk monitoring of investment funds and their managers. A significant proportion of the regulatory framework in this area, in particular related to the conduct of business and disclosure requirements, has been harmonized at the EU level and is largely in line with the relevant international standards.⁴ As a result, this note focuses on the areas where the EU requirements leave room for discretion by member states and where IOSCO recently has issued more

³ The main author of this note is Tanis MacLaren, an external expert to the Monetary and Capital Markets Department of the IMF. The on-site work supporting the findings and conclusions was conducted during the period September 20–October 4, 2016. The information in this note is current as of October 1, 2016 unless stated otherwise.

⁴ The EU regulatory framework has been reviewed in light of IOSCO Principles 24–28 on CIS.

detailed standards.⁵ Particular emphasis has been placed on requirements with most direct relevance for financial stability, namely valuation, segregation and safekeeping of fund assets, and redemption of fund units. In addition, the mission reviewed how the supervisors have applied the regulatory framework in practice in authorizing and supervising firms and funds, and how the authorities are addressing any potential systemic risk arising from fund management.

A. Regulatory Structure

4. The structure of financial regulation in the Netherlands follows a functional (“twin peaks”) approach. The structure is embedded in the Act on Financial Supervision (Wet op het financieel toezicht, Wft), which charges the DNB with prudential supervision and the AFM with conduct supervision of all participants in the financial sector. The Wft is clear in relation to the supervisors’ core mandates and objectives. The DNB’s prudential supervision mandate is to focus on the soundness of financial enterprises and their contribution to the stability of the financial sector, while the AFM’s supervision of conduct of business is to focus on orderly and transparent financial market processes, integrity in relations between market parties and due care in the provision of services to clients. Since 2014, the statute expressly states the AFM’s business conduct mandate also should support financial stability. The authorities’ respective mandates appear to be well understood by both the financial supervisors and market participants.

5. The AFM is the primary authority responsible for the supervision of securities markets in the Netherlands. In addition to its responsibility in conduct supervision, the AFM has specific responsibilities stemming from other laws including: (i) licensing, registration and supervision of audit firms and statutory auditors (Audit Firm Supervision Act—Wet toezicht accountantsorganisaties (Wta)); (ii) supervision of financial reporting by issuers (Act on Supervision of Financial Reporting)—Wet toezicht financiële verslaggeving (Wtfov); and (iii) consumer protection, mainly with respect to exempted issuers that engage in “abusive” offerings (Consumer Protection Enforcement Act). The AFM also has responsibilities under various EU regulations, including those on market abuse and market infrastructure. The mandate to hear individual complaints of customers belongs to the Financial Services Complaint Tribunal and the Financial Ombudsman.

6. The DNB is responsible for the prudential supervision of firms providing services and carrying out activities in the capital markets. Prudential supervision includes the supervision of compliance with initial and ongoing capital, own funds and liquidity requirements, and supervisory reporting and supervision of risk management. The remit of the DNB includes prudential supervision of UCITS management companies, AIF managers, investment firms licensed under the MiFID,⁶

⁵ Relevant IOSCO work includes Principles of Suspensions of Redemptions in Collective Investment Schemes (CIS), January 2012; Policy Recommendations for MMFs, October 2012; Principles of Liquidity Risk Management for CIS, March 2013; Principles for the Valuation of CIS Assets, May 2013; and Standards for the Custody of CIS Assets, November 2015.

⁶ Directive 2004/39/EC of the European Parliament and of the Council of April 21, 2004, on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council, and repealing Council Directive 93/22/EEC OJ 2004, L 145.

insurance companies, pension funds, and banks. Banks licensed by the DNB can provide investment services and activities directly without a separate license from the AFM, however, the bank must get express permission from the DNB to carry out investment services and activities. The AFM is involved in the decision to permit broadening of the bank's license.

7. Both the AFM and the DNB undertake their supervision responsibilities by carrying out inspection, enforcement, education and other activities. They also gather and use information from both public market reports and reports prepared by their own inspection and investigation teams. In cases of noncompliant behavior, the AFM and the DNB may impose a range of measures, such as issuing mandatory instructions, imposing orders for interim penalty payments⁷ or administrative fines, withdrawing or limiting a license, or filing a report with the Public Prosecution Office (Openbaar Ministerie).

REGULATOR ISSUES

8. The IOSCO principles require that securities regulators have (a) adequate powers, proper resources and capacity to perform their assigned functions; and (b) be operationally independent and accountable in the exercise of those powers and functions (IOSCO Principles 2 and 3). Key aspects that support these Principles are (a) having full authority to license, inspect, enforce, and regulate the participants in the capital markets; (b) a stable source of sufficient funding to carry out their tasks effectively and ensure that they can hire and retain skilled staff; (c) operational independence from political or commercial intervention; (d) legal protections for staff and governing body personnel from dismissal or lawsuits; (e) adequate transparency of operations and use of funds; and (f) due process in carrying out tasks. The regulator's independence must be balanced by suitable accountability for its actions, such as through mechanisms that provide transparency regarding its operations and use of funds. The balance is a fine one. Care must be taken to ensure that accountability mechanisms not only do not affect the supervisors' independence in practice, but also do not create a perception of a lack of independence that may be damaging to the public confidence in the system.

A. Independence

Sufficiency of funding

9. The funding of financial supervision in the Netherlands is governed by a dedicated law. The Financial Supervision (Funding) Act (Wet bekostiging financieel toezicht, Wbft) contains a detailed process to be followed in setting a regulatory budget. An Advisory Panel, consisting of representatives of supervised entities, is consulted but has no formal decision-making powers. The

⁷ An order for interim penalty payment (sometimes also referred to as an incremental penalty payment) is an instrument that is used to order (instruct) a company or person to perform or cease performing a certain act. If the order is not complied with within the term set, the company/person involved has to pay a sum of money. For example: the firm is ordered to provide specified information by a particular date, failing which it will be charged US\$1,000 a day for every day that the information is late.

proposed budgets of the AFM and the DNB are discussed with their respective Supervisory Boards and then sent to the Minister of Finance and the Minister of Social Affairs and Employment for approval. The ministers may withhold approval if the budget is “contrary to the law or public interest,” after prior consultation with the authorities. There is no black-line law or jurisprudence on what constitutes “contrary to the public interest.” In practice, there is a dialogue with the Ministers on the size of the supervisors’ budgets. After approval, each budget is published in the Government Gazette. In the course of the year, if there are substantial differences between the actual outcome and the budget, the Ministers are to be notified. Once approved, the supervisors may reallocate resources to deal with changing demands. The Ministers must approve any budget overruns. This is done at the time the approval is given for the annual financial statements. If there are unforeseen events that have a substantial impact on the funds needed to fulfill required tasks, the authorities may request additional funds from the MoF. An agreement on the overall framework for funding the two supervisors for the next four years was recently reached with the government. The new framework expressly includes a flexible component that grows over the term of the framework.

10. The supervisors are fully funded by the industry. The AFM and the DNB are funded by the sectors that they supervise through annual contributions (levies), fees for registrations and permits (the tariffs are set by the MoF), and fines.⁸ The AFM and the DNB allocate costs to various industry segments. The allocation paid by each industry segment is based on the characteristics of the supervisory duties for each segment, taking into account the perceived risks of the supervised firms.

11. The budgets are viewed by the supervisors as being sufficient to meet their current risk-based priorities, but will be challenged both by increasing regulatory demands and pressure for reduced costs. The AFM and the DNB apply a risk-basis to their activities; priorities are based on regularly updated risk analyses of the conditions in financial markets and at individual supervised entities. In the authorities’ view, the available budget enables the AFM and the DNB to address the most important risks and to fulfill their roles effectively. In fact, both supervisors noted that they routinely have had money left over at the end of each budget period. However, the expectations for and demands on financial supervisors continue to grow, and both supervisors face challenges to supervise effectively and efficiently with the given resources. Further, in July 2016, when delivering the cost frameworks of the two supervisors to Parliament, the MoF indicated that the supervisors were expected to reduce their supervision costs over the next four years. The reduction in 2017 is expected to be 1.75 percent, while in 2020 the target is 7 percent. This will put additional pressure on the ability of the supervisors to carry out the full scope of their duties in the appropriate depth.

⁸ The supervisors do not retain the actual proceeds of administrative fines and other penalties they impose. The first €2.5 million generated from fines and penalties levied by the AFM and the DNB in any year are rebated to the industry the following year; that is, they reduce the overall fees to be paid by each industry segment. Any revenues above this amount are transferred to the government.

12. The AFM is exploring the possibilities of using data more intensively in its supervision activities (data-driven supervision). The new Asset Management division is taking part in one of the first pilots to explore how various data available on CIS can be used for supervision (discussed in detail below) The AFM's ambition to become a more data-driven supervisor will require additional investments in technology and skills, putting additional pressures on its supervisory budget.

13. Present compensation levels are sufficient to attract and retain the necessary expert staff, but this may be more difficult in the immediate future. According to IOSCO, a key aspect of being an independent regulator is having the resources and ability to obtain and keep staff with the requisite expertise.⁹ The staff compensation levels at the supervisors have been benchmarked to industry and governmental salaries. For most staff positions, overall compensation is sufficient to attract and keep staff with the necessary skills and experience. However, other positions require more specialized skills and experience, and it is becoming more difficult to find the right staff. The attractiveness of the terms of employment is becoming more of a concern.

14. New salary rules are likely to exacerbate the staffing challenges. The members of the governing boards of AFM and the DNB are now subject to the Act on Standards for Remuneration for Senior Officials in the Public and Semi-Public Sector (Wet normering topinkomens, WNT). This Remuneration Act caps these persons' compensation at a maximum of 100 percent of a government minister's salary and the cap is effective for current board members as of January 1, 2017. Salaries above this limit are to be rolled back. The MoF may give exceptions on a case-by-case basis but has ruled out granting blanket exemptions. Two current AFM Board members and all members of the DNB Board have exemptions, and thus will be able to keep their current remuneration during their terms of appointment. A proposal to extend the WNT cap to all staff (WNT-3) is currently out for consultation, and it is expected that this will affect the salaries of current staff at the supervisors. WNT-3 is likely to have an adverse effect on AFM's and the DNB's ability to attract and retain staff, especially at the middle- and higher-management levels, and staff with very specialized expertise. The MoF is of the opinion that the draft amendment offers enough flexibility to the supervisors because the maximum remuneration is sufficient and exemptions are available on a case-by-case basis. The salary cap and necessity for individual approval from the MoF for hiring decisions will both make finding the right people for key tasks more difficult and raise independence issues. To address these concerns, the two supervisors should be granted a high level of autonomy for deciding on exceptions to the WNT.

Accountability

15. AFM and the DNB are accountable for their supervisory activities. The budget identifies the objectives of financial supervision for the upcoming year, based on the government-wide framework of outcome-oriented budgeting. At the end of the budget year, the AFM and the DNB each have to draw up an accounting report relating to the duties assigned under the Wbft. The accounting reports are accompanied by a statement of an auditor, regarding fair presentation, and a

⁹ Principle 3, Key Issue 3 and Key Question 3.

report on whether the collection and deployment of resources are in accordance with the Wbft. To avoid conflict of interest issues, the AFM is subject to review by a registered auditor of the Audit Department (Auditdienst Rijk, ADR) within the MoF. A public audit firm audits the DNB. Approval of the accounting reports is given by the MoF and the Ministry of Social Affairs and Employment and may only be withheld if the report is contrary to law or public interest. Each supervisor publishes its budget and annual report on its website.

16. The DNB is subject to additional oversight of its activities by government bodies. Its supervision of pension providers may be reviewed by the Inspection Service for Work and Income on behalf of the Minister of Social Affairs and Employment. This supervision involves regular spot checks and the exchange of information. Also, the Netherlands Court of Audit is entitled to conduct performance audits of the DNB with respect to “national tasks” performed by the DNB. The Court of Audit has legal authority to demand confidential information obtained by the DNB in the execution of its supervisory tasks, if such information is necessary for the execution of the public tasks of the Court of Audit.

Transparency

17. The AFM and the DNB aim to be as transparent as possible within the statutory framework. The supervisors are subject to a general duty that requires maintaining the confidentiality of data and information they obtain in the performance of their duties. The supervisors also have a wide variety of transparency obligations. As an essential part of their supervisory strategies, supervisors publish their plans, activities and the effects of their activities. Both supervisors publish results of thematic inspections, but without identifying individual firms. The AFM has wider power to publish its principal findings and conclusions from its inspections at audit firms and may identify the firms, provided no identifying information regarding the audit clients or third parties appears. Where fines and other significant penalties have been imposed as a result of enforcement actions, these matters are published after five working days. If preliminary relief is sought, publication of the decision is delayed pending the hearing judge rendering judgment. All rules and regulations have to be made public. This includes amendments (and the reasons underlying the amendments) to rules and regulations.

18. Extensive due-process requirements apply to all administrative tasks carried out by both supervisors. The AFM and the DNB, as administrative authorities, have to comply with the provisions of the General Administrative Law Act (Algemene wet bestuursrecht, Awb). These provisions require due process be followed in the exercise of all administrative functions. For example, if the AFM proposes to deny a license or impose a fine, every party negatively affected by that decision is entitled to a hearing prior to the AFM taking the proposed action. Every administrative decision must be based on sound reasons, giving weight to the principles of subsidiarity and proportionality. The reasons for the decision must be delivered to the party concerned before the decision becomes effective. The reasons usually are delivered within one week after the decision is made. The effected

person may file a notice of objection. The Executive Board of the AFM will then reconsider the original decision. Its decision on the notice of objection may subsequently be appealed in administrative court. Objections to non-administrative decisions or other conduct of the authority can be brought before the District Court.

B. Legal Protection of Governing Body and Staff

19. The executive board members of the AFM and the DNB are appointed for fixed, renewable terms by royal decree; the supervisory board members of the AFM are appointed by the MoF directly or in respect of the DNB by the MoF acting for the State as the sole shareholder of the DNB. AFM Executive Board Members are appointed by royal decree on the basis of a nonbinding proposal of the Supervisory Board. The Chair and the other members of the AFM's Supervisory Board are appointed by the Minister of Finance for four years, which can be renewed. All Executive Board Members have a full-time appointment at the AFM. The duration of an appointment is four years and can be renewed. Under the law, each member of each board must be a person whose reliability is beyond doubt and who is suitable for the performance of his/her duties. The appointment of the members of the DNB's Executive Board is laid down in the Bank Act 1998. The President and Executive Directors are appointed by royal decree for a term of seven years. Executive Board members may be reappointed once to the same position. The members of the Supervisory Board of the DNB are appointed by the shareholders of the Bank (in practice, the MoF acting for the government, which is the sole shareholder) for a term of four years.

20. All of the members of the governing boards of the supervisors can be dismissed. The Executive Board members of the AFM, and the Executive Directors and members of the Supervisory board of the DNB can be dismissed by royal decree if they fail to meet the requirements for the exercise of their duties or are guilty of serious misconduct. The MoF may suspend or dismiss the Chair and the other members of the Supervisory Board of the AFM if they are unsuitable, incompetent or for other important reasons relating to the person involved.

21. The reasons for dismissal are principles-based and thus may be subject to varying interpretation. The law does not specify what constitutes "no longer fulfilling the conditions required for the performance of their duties," "serious misconduct" or "other important reasons relating to the person." This leaves a great deal of leeway for the exercise of discretion by the government and may lead to a perception of a lack of supervisory independence. To be consistent with the relevant IOSCO criterion¹⁰ would require both the Bank Act and the Wft to be amended to provide that a board member may **only** be removed for specified, objective causes (such as bankruptcy, persistent failure to attend meetings, acting in conflict of interest, etc.).

22. There are clear statutory provisions that protect supervisors, the members of their Executive and Supervisory Boards, and their employees from legal responsibility for damages that result from actions taken in the course of their supervisory activities. The 2011 assessment

¹⁰ Principle 2, Key Question 5.

noted that the protection of the supervisors and their personnel from lawsuits relied on jurisprudence and general provisions of the Civil Code, which was seen to be less than ideal. Unambiguous protection established by statute was preferable. The law has since been amended to make it clear that none of these parties are liable for damage caused by an act or omission in the performance of a task or power conferred under a statutory provision, unless this damage is largely the result of a deliberate improper performance of duties, an improper exercise of powers or due to gross negligence. The statutory protection is buttressed by the Dutch Civil Code provision that makes the employer liable for the actions of its employees. These provide broad protection for the supervisors, their board members and their employees from being found liable to pay damages for actions taken in carrying out their jobs. Like virtually all statutory immunity provisions, it does not completely eliminate the possibility of being sued, but this is not a high risk in the Netherlands. When staff have been called to be present in court proceedings, the authorities have provided legal support.

C. Powers

23. The supervisors have the key powers necessary to carry out their responsibilities, but some additional authority would enhance the effectiveness of the system. The AFM and the DNB have full authority to license, inspect, enforce, and regulate the participants in the securities markets, and the AFM has the necessary powers to carry out its audit oversight responsibilities. However, the regime depends largely on authority set out in government-made statutes and regulations (or those made at the EU level), and so it is not particularly nimble. Also, supervisors could use some additional powers to equip them to address the increasing complexity of the markets supervised, such as the ability to make legally binding rules as discussed below.

24. The AFM and the DNB have wide powers to request and obtain any information from any person that is deemed reasonably necessary for the due fulfillment of the supervisors' responsibilities and exercise of their powers. The 2011 assessment noted some gaps in the authority of the supervisors to obtain all information to carry out their tasks. The AFM and the DNB are now empowered to:

- Enter all places without permission of the owner, with the exception of personal residences, if necessary in collaboration with the criminal law authorities and by the use of force;
- Claim any information that is reasonably necessary for the due fulfillment of its responsibilities and exercise of its powers, including by taking or compelling a person's statement. When using this power, the consequences for the person(s) concerned may not be disproportionate to the purposes served by the request for information. The AFM does not have authority to take a testimony under oath; and
- Access business data and documents and make copies.

25. Failure of any person to cooperate in providing the requested information is subject to sanctions.

Rule-making authority

26. The financial supervisors do not have broad authority to make legally binding instruments (rule-making authority). The supervisors have the authority to issue measures such as supporting guidelines and interpretations of rules, but only have authority to make legally binding instruments where a specific statute explicitly has granted them that power. Where the power exists, it usually addresses very technical aspects of regulation. All other rule-making authority belongs to the legislature or the MoF. Where the AFM and the DNB have such authority, they are required to consult an eligible representative delegation from the institutions under their supervision. Further, regulatory powers can only be vested in the DNB when it concerns organizational or technical matters. Only in special circumstances are the supervisors more generally authorized to impose binding regulations without the need for a specific delegating provision, and these must be of temporary effect. The AFM may do so in order to improve the orderly and transparent financial market processes. The DNB is vested with the power to act in the interest of financial stability, such as when large and uncontrolled market movements occur that result in severe unrest in the financial sector.

27. IOSCO does not expressly say that securities regulators have to have rule-making authority; however, they must be able to act promptly when needed to address developing issues. Securities markets are changing at an ever-increasing rate and sometimes in unexpected ways. In order to be able to act promptly and appropriately in response to developments, the AFM and the DNB need the right tools. These tools include the ability to act flexibly, quickly and in a way that is legally enforceable. In particular, the supervisors should be able to fill in gaps in technical areas where there are no relevant EU regulations or national requirements. Legal reform should be pursued to expand the rule-making authority of the AFM and the DNB.

28. While the MoF does not have to be consulted before legally binding instruments are made, the MoF has discretionary power to revoke them. Where either authority has issued legally binding regulations, there is no obligation to consult the MoF. However, the supervisor must notify the MoF without delay. The Minister may revoke the regulation if, in the Minister's opinion, it contravenes a law, treaty or binding decision of an international organization, or if it imposes an unreasonable burden on financial markets. The supervisor must be consulted first and be given an opportunity to amend the regulation to eliminate the problem. The Minister has never used these powers of revocation. In particular, there is no binding guidance that governs what criteria are to be applied in reaching a decision that something "imposes an unreasonable burden on financial markets" and the resulting ability of the Minister to exercise his discretion may raise questions about the independence of the supervisors and thus ties into the discussion above. IOSCO generally would require that the circumstances in which such an action is permitted should be clear and the process sufficiently

transparent or subject to review to safeguard its integrity.¹¹ The MoF should consider further clarifying the conditions under which the powers to set aside rules of the supervisors would be exercised and those circumstances should be transparent to the public.

Other gaps

29. There is an annual process to identify and inform the legislature of necessary and/or desirable new legislation to improve the ability of the supervisors to carry out their responsibilities. Each supervisor prepares an annual Legislation Letter that identifies desirable reforms, and the MoF forwards these to the House of Representatives. The 2016 AFM Legislation Letter contains, among other issues, a request to extend the powers of the AFM to (i) obtain records kept by providers of telecommunication and data exchange; and (ii) freeze securities/bank accounts. At the moment, only the public prosecutor has these powers. IOSCO recently announced an Enhanced Multilateral Memorandum of Understanding (Enhanced MMoU) on Cooperation and the Exchange of Information. The Enhanced MMoU would require the securities regulator to be able to obtain and share telephone and internet service provider records and to advise on freezing of assets or freeze assets on behalf of another regulator. Both of these powers can be key tools in pursuing enforcement actions and protecting investors' assets from leaving the jurisdiction improperly. It is recommended that the AFM's authority to obtain information and freeze assets be expanded as the AFM has requested and that the authorities make the necessary changes to the relevant legislation.

30. The ability of the supervisors to carry out their tasks effectively would be enhanced if they were given authority to use outside experts to conduct inspections/investigations on the supervisors' behalf. With the complexity of the marketplace increasing, the need for supervisors to have access to extensive, specialized expertise is increasing in tandem. It is neither feasible, nor necessary to have all expertise in-house, if the supervisor has the authority to engage the appropriate external experts as required to act on the supervisor's behalf. It may also add value, in some circumstances, to engage independent parties to conduct examinations so as to foster public confidence in both the process and conclusions. In recent legislative letters, both supervisors have asked the MoF in for this authority to be added to their regulatory toolkit. Many supervisors have such legal authority and often may require the supervised firm pay the cost of the expert's examination. It is recommended that this authority be given to the supervisors and that the authorities make the necessary statutory changes. Note that the supervisors should have the ability to make use of outside experts for supervisory activities in all sectors, not just securities.

Summary

31. The supervisors have operational independence, sufficient powers and are suitably accountable for their tasks on a day-to-day basis, but some concerns exist. The line between independence and accountability is difficult to draw. While supervisors may operate independently on a day-to-day basis and the accountability mechanisms are extensive, some aspects of the system may raise concerns depending on how they are used in practice. Such features include: the ministerial

¹¹ Principle 2, Key Issue 3, Key Question 2(c) and the related explanatory notes.

control over the budget; the authority of the MoF to set aside rules enacted by the supervisors; and the cap proposed to apply to staff salaries which may limit the supervisors' ability to hire and retain staff with specialized expertise. Even if these features do not directly affect the supervisors' independence in practice, they may create a perception of a lack of independence that may be damaging to the public confidence in the system. The risks of impairment of independence could be reduced by the implementation of the recommendations as above, such as greater autonomy over the budget, and the addition of some clear and objective criteria for the exercise of the power to dismiss members of the governing boards or overrule a supervisory regulation. The supervisors' ability to fully and effectively supervise the markets and take action where problems are identified would be improved by some expansion of their authority.

MARKET-BASED FINANCE

A. Crowd Funding

32. Debt and equity-based crowd-funding is regulated under the general capital-raising rules, rather than a separate, purpose-designed framework. There is no specific regulatory framework for crowd-funding in the Netherlands, however, the activities of crowd-funding sites that offer loans or equity investments fall within the supervisors' regulatory scope.¹² The current regulatory framework applied governs capital-raising generally. As a result, the Netherlands applies three regimes to crowd-funding that differ depending on the business model used by the various platforms. The three regimes are as follows:

- Platforms that operate using an exemption granted by the DNB¹³ or the AFM that allows public solicitation of loans for small- and medium-sized enterprises (SMEs). These exemptions may be granted when the authorities are satisfied their respective regulatory concerns (prudential or investor protection) are met. The conditions that have to be met to obtain an exemption from the AFM are extensive¹⁴ and include requirements for fit-and-proper operators, regular and ad hoc

¹² The other two forms of crowd-funding—donation-based and reward-based—are not caught by the regulatory regime.

¹³ The DNB's role in the supervision of crowd-funding relates to the compliance and enforcement of the prohibition on receiving deposits or other repayable funds from the public by crowd-funding platforms or related parties that do not qualify for the exemptions for loan-based crowd-funding; the possible overlap with the provision of payment services within the meaning of the Payments Services Directive; and the prudential supervision of crowd-funding platforms that operate under an AFM license as investment firm or fund manager.

¹⁴ These conditions include: (1) a limitation on how much an investor may place per crowd-funding platform; (2) an initial and periodic test for investor suitability; (3) the ability for investors to unwind transactions within 24 hours; (4) a mandatory advice from the platform to limit the investments in crowd-funding to a certain percentage of the available free investable assets and to spread their investments; (5) a defined and public procedure of the handling of loan propositions; (6) fit and proper management and sound business operations; (7) requirements on the publication of information with respect to loan propositions; (8) a set procedure for risk classification of the proposed loans; (9) procedures for ensuring segregation of investor assets from those of the platform; and (10) obligations to report incidents and provide reports every six months on turnover, transactions, defaults, etc.

reporting to the regulator and a variety of provisions designed to protect investors from inappropriate investments and excess risk.

- Platforms that are licensed as financial services providers¹⁵ under the Wft. This license regime applies to platforms intermediating loans to consumers (mortgage loans and consumer credit). The platforms applying for this license also need an exemption from the AFM as above.
- Platforms that are licensed as investment firms under MiFID, permitting specified investment services¹⁶ in debt and equity. The MiFID investment firm license is also applicable in other member states of the European Economic Area (EEA).

Table 2. Netherlands: Crowd-Funding Data, as of September 30, 2016

| Number of Platforms by Type of Supervision Regime | |
|---|-------|
| Exemption | 36 |
| Financial services providers | 4 |
| Investment firms | 5 |
| Total | 45 |
| Value of Transactions Carried Out (In millions of euros) | |
| Loans | 98.9 |
| Equity | 4.5 |
| Total | 103.4 |

Source: AFM.

33. Regulation of the activities of these platforms requires a careful balancing of regulatory objectives. While the present level of activity is fairly small, debt and equity-based crowd-funding is viewed as a potentially important source of funding for SMEs in the Netherlands. As a result, the AFM seeks to balance the objectives of facilitating innovation and the growth of this segment while still providing a suitable level of investor protection. The terms and conditions imposed on platforms seeking an exemption are broadly consistent with IOSCO investor protection expectations as expressed in the Principles.

¹⁵ "...financial service provider: a party that offers a financial product other than a financial instrument, that advises on a financial product other than a financial instrument or that provides brokerage services, provides reinsurance brokerage services or acts as an authorized agent or authorized sub-agent."

¹⁶ "...to receive and forward, in the pursuit of a profession or business, client orders with regard to financial instruments" and "...to place financial instruments when they are offered ... without a firm commitment basis, in the pursuit of a profession or business."

34. Crowd-funding has attracted a great deal of regulatory interest, but no consensus has emerged on appropriate minimum standards. Recently, both IOSCO¹⁷ and the European Commission (EC)¹⁸ issued studies on the state of development of crowd-funding markets and issues that these markets may raise. The platforms largely operate within countries, and they are subject to greater or lesser regulation at the national level, which differs from country to country. However, while the form and content of these regulations may differ, they are consistent in their broad approach, as they aim at enabling the development of this funding mechanism while addressing key risks that may arise, notably for investors. The EC paper concluded that there was no strong case for EU-wide regulation at the moment, but that efforts should be devoted to promoting convergence, sharing of best practices and keeping developments under review. The IOSCO statement proposed no international standard at this time but identified a number of concerns about which regulators should be aware and some common approaches that have been applied. The AFM approach takes into account the issues and concerns identified by IOSCO, and it applies consistent measures.

35. A fully separate regime for crowd-funding may not yet be required, but some adjustments to the present arrangements may be appropriate. The AFM sees no need for a separate, detailed regulatory framework for crowd-funding at this time. However, the current split system is not ideal as it raises the potential for disparate regulation of similar activities,¹⁹ and the exemption route does not provide unambiguous authority to supervise the platforms on an ongoing basis. The AFM's 2016 legislative letter to the MoF requested that some general provisions regarding loan-based crowd-funding be added to the relevant legislation, which would allow the authorities to develop, if and when needed, more detailed requirements in regulations to respond quickly to developments in the area. The AFM's request to introduce these general requirements for crowd-funding is supported, and it is recommended that the authorities implement the necessary changes in the near term.

B. Asset-Backed Securities/Securitizations

36. The Dutch regime governing disclosure with respect to asset-backed securities and structured products is largely determined at the EU level. In the Netherlands, the Prospectus and Transparency Directives have been transposed into the Wft. The disclosure requirements for asset-backed securities and structured products that are offered to the public and/or are admitted to trading on a regulated market follow from these Directives and the related regulations. The Dutch authorities have added a requirement to the Prospectus Directive that the information in the prospectus must be consistent with other related information that is available within the AFM. This means, for example, that the prospectus information on the risk factors related to securities where the

¹⁷ IOSCO, Statement on Addressing Regulation of Crowd-funding, December 2015.

¹⁸ EU Commission Staff Working Document, Crowd-funding in the EU Capital Markets Union, SWD (2016) 154 (Brussels, 2016).

¹⁹ IOSCO Principle 1, Key Issue 2 says similar conduct and activities should be subject to consistent regulatory requirements. This is targeted at the situation where responsibility for supervising aspects of securities activities are split between more than one authority, but the underlying need for consistency equally applies in this situation.

underlying assets are mortgages must be consistent with the (identified) risk that redemption of the outstanding amount of such mortgages could lead to a decrease in the cash flows to the issuer of the asset-backed securities.

37. The AFM's prospectus review process is both risk-based and comprehensive. All prospectuses are reviewed, as the AFM considers the prospectus review process serves an important gate-keeping function in regulating access to the capital markets. However, it also applies a risk-based approach to the review, resulting in more focus on specific information elements within the disclosure documents, and less effort in clarifying other less critical elements. It uses a structured approach, utilizing both internal and external sources of information, to perform a risk assessment of the transaction and identify the Key Points of Review (KPRs). These KPRs can be general, issuer or transaction specific, and steer the review. For asset-backed securities, the review strategy focuses on the quality of the pool of underlying assets, as expressed in the stratification tables, and the description of risk factors required by the relevant annexes of the Prospectus Regulation. These are reviewed in detail for every prospectus. The review also takes into account the expected purchasers of the issue. For example, a prospectus for a retail offering would be expected to provide the required information to investors in a way that would be understood by that audience, such as by using simpler language and clear examples of what is meant.

38. The prospectus will only be approved when it fulfills the requirements from the Prospectus Directive, the Prospectus Regulation and the recommendations of ESMA. If the prospectus is not approved, the securities cannot be listed on the market. Failure to have an approved prospectus where required is an offense, and it gives rise to administrative and general criminal penalties. In addition to the prospectus review, the AFM also reviews marketing material (including roadshow information) for retail offerings.

39. The Dutch market for securitization of Dutch assets is largely domestic and the investors are institutions. An infinitesimal percentage of securitizations (0.001 percent) are sold to Dutch retail investors, and the majority of the value of issues by Dutch originators is retained by those issuers for liquidity purposes. Five domestic banks are issuers. Unlike many countries where the bulk of securitization transactions take place in the exempt market, all issues are listed on a regulated market in order to facilitate sales to investors.²⁰ Where foreign originators have securitized foreign assets using a Dutch special purpose vehicle (SPV), virtually all of those securities are sold outside the Netherlands.

²⁰ Most institutional investors and many CIS have investment restrictions mandating the purchase of instruments listed on a regulated market, and they have a very limited ability to purchase or hold unlisted securities.

Table 3. Netherlands: Securitizations by Dutch Originators

(Mainly Dutch underlying assets)

| Year | Number of issues | | | Value of Issues (In millions of euros) | | | Outstanding Amounts (In millions of euros) | | |
|------|------------------|----------|-------|---|----------|---------|---|----------|---------|
| | Placed | Retained | Total | Placed | Retained | Total | Placed | Retained | Total |
| 2010 | 17 | 9 | 26 | 22,807 | 114,839 | 137,646 | 107,735 | 225,571 | 333,306 |
| 2011 | 14 | 17 | 31 | 12,256 | 74,457 | 86,713 | 99,067 | 219,905 | 318,972 |
| 2012 | 16 | 7 | 23 | 13,061 | 41,019 | 54,080 | 83,816 | 209,839 | 293,655 |
| 2013 | 14 | 7 | 21 | 15,243 | 23,985 | 39,228 | 81,280 | 184,855 | 266,135 |
| 2014 | 13 | 4 | 17 | 10,292 | 15,267 | 25,559 | 75,143 | 180,896 | 256,038 |
| 2015 | 6 | 5 | 11 | 5,540 | 14,754 | 20,294 | 56,885 | 166,539 | 223,424 |

Source: DNB.

Note: Placed means sold to third-party investors; retained means held by the originator, mainly for liquidity purposes, such as for repos with central banks.

Table 4. Netherlands: Foreign Securitizations by Foreign Originators Using Dutch SPVs

(Mainly foreign underlying assets)

| Year | Number of Issues | Value of Issuance (In millions of euros) | Outstanding Amounts (In millions of euros) |
|------|---------------------|---|---|
| 2010 | | 8,522 | 105,306 |
| 2011 | | 7,845 | 94,310 |
| 2012 | | 9,112 | 88,284 |
| 2013 | 30 | 9,150 | 74,742 |
| 2014 | 18 | 9,412 | 66,365 |
| 2015 | 14 | 9,322 | 61,034 |

Source: DNB.

Table 5. Netherlands: Dutch Securitizations by Type of Investor

(Value of investments in millions of euros)

| | Dutch Banks | Dutch Institutional Investors | Dutch other Financial Institutions | Dutch Households | Non-residents | Total |
|------|-------------|-------------------------------|------------------------------------|------------------|---------------|---------|
| 2013 | 173,807 | 4,694 | 9,255 | 7 | 78,378 | 266,141 |
| 2014 | 167,970 | 5,752 | 7,903 | - | 74,414 | 256,038 |
| 2015 | 155,775 | 4,441 | 7,181 | 2 | 56,027 | 223,426 |

| Foreign Securitizations by Type of Investor | | | | | | |
|--|-------------|-------------------------------|------------------------------------|------------------|---------------|--------|
| (Value of investments in millions of euros) | | | | | | |
| | Dutch Banks | Dutch Institutional Investors | Dutch other Financial Institutions | Dutch Households | Non-residents | Total |
| 2013 | 346 | 1,154 | 198 | 5 | 73,039 | 74,742 |
| 2014 | 361 | 1,216 | 163 | 5 | 64,621 | 66,365 |
| 2015 | 381 | 1,463 | 109 | 3 | 59,078 | 61,034 |

Source: DNB.

Note: Includes retained securitizations.

AUDITOR OVERSIGHT

40. A complete framework for audit and auditor oversight is a necessary component of an effective securities regulatory regime. The proper operation of the capital markets depends on accurate and complete financial reporting by public issuers and financial firms, backed up by diligent audits by independent auditors. The IOSCO principles recognize this key role for audit and expect that there be a complete and effective framework for audits and auditors as part of the overall regulatory regime for capital markets. The IOSCO standards expect three aspects to be fulfilled by the audit framework:

- Independent, qualified auditors operate, and are seen to operate, in an environment that supports objective decision-making on key issues having a material effect on financial statements;²¹
- Audits are performed using high-quality auditing standards;²² and

²¹ Principle 20.

²² Principle 21.

- The reliability and integrity of the financial reporting process is supported by effective oversight of those performing audit services by a body independent of the auditing profession and acting in the public interest.²³

A. Audit and Auditor Requirements

41. Dutch law requires a wide array of entities to be audited by approved auditors.

Approximately 21,000 entities—ranging from governmental bodies²⁴ to private companies—are required by law to have their financial statements audited (referred to as the statutory audit requirements). The Wta²⁵ distinguishes between PIEs and other entities. PIEs include listed companies, banks, and insurance companies.²⁶ PIEs make up about 5 percent of all entities subject to the statutory audit requirement.

Table 6. Netherlands: Number of Statutory Audits

| Number of statutory audits | 2013 | 2014 |
|------------------------------------|--------|--------|
| Number of statutory audits at PIEs | 1,049 | 979 |
| Non-PIE statutory audits | 20,704 | 19,875 |
| Total number of statutory audits | 21,753 | 20,854 |

Source: AFM Monitor.

42. The main obligations for Dutch audit firms and auditors are set out in legislation, regulations and binding standards. Auditor obligations stem from EU Regulation 537/2014, the Wta, the Audit Firms Supervision Decree (Besluit toezicht accountantsorganisaties (Bta)) and professional audit standards issued by the Dutch Institute of Chartered Accountants (Nederlandse Beroepsorganisatie van Accountants (NBA)). Stricter legal requirements are applicable for the statutory audits of financial statements of PIEs.

43. Only audit firms that have been granted a license by the AFM may conduct statutory audits. There are two types of licenses: PIE audit and non-PIE audit (for all other statutory audits). Stricter licensing criteria apply to PIE-audit firms. As of July 2016, there are 9 licensed PIE audit firms²⁷

²³ Principle 19.

²⁴ Including municipalities, provinces, water boards, housing corporations and a number of autonomous administrative authorities like the Dutch Media Authority, the Dutch Cadastre, Land Registry and Mapping Agency, the Dutch Healthcare Authority, and the Dutch Air Traffic Control.

²⁵ Audit Firms Supervision Act ('Wet toezicht accountantsorganisaties').

²⁶ This is consistent with the minimum list of PIEs set out in Article 1 of Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings and in Article 2 of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (as amended by Directive 2014/56/EU). Collective investment schemes and investment firms licensed under MiFID have not been designated as PIEs. Such designation is permitted but not required by the directive. These firms are subject to audit by statutory auditors under other EU directives.

²⁷ A tenth firm is licensed to perform PIE audits but does not currently engage in auditing activities.

and 342 licensed non-PIE audit firms. There are 704 auditors employed by or affiliated with PIE-audit firms and 1070 auditors employed by or affiliated with non-PIE-audit firms. With the implementation of EU Directive 2014/56/EU, the AFM will also be responsible for the registration of audit firms approved in other EU member states. Upon registration, these audit firms will also be allowed to carry out statutory audits in the Netherlands.

44. The licensing process includes a comprehensive off-site review of the applicant firm's compliance with the required initial standards. The AFM will grant a license to an applicant that has demonstrated that the firm and the auditors employed by or affiliated with the firm comply with the standards laid down in the law. For non-PIE audit firms, these requirements include:

- Trustworthy natural persons who determine the day-to-day policies of the audit firm; these persons must be knowledgeable about the quality-control system used by the audit firm;
- The firm's ownership and control structure does not impede supervision;
- It must have a suitable quality-control system;
- Appropriate measures must be in place to ensure the firm is independent from its audit clients;
- It must have policies and procedures to ensure the confidentiality of all data received in the course of the performance of the statutory audit; and
- It must have appropriate policies and procedures in place to manage the firm to ensure controlled and sound business operations.

45. PIE-audit firms must meet higher standards. Audit firms who wish to obtain a license for PIE-audits must comply with additional standards set out in the law. These include enhanced transparency requirements and stricter obligations regarding the audit firm's quality-control system and independence (discussed below). For example, the firm must appoint a compliance officer to monitor the audit firms' and auditors' compliance with the applicable legal requirements and have a quality-control review system.

46. Compliance with required standards is confirmed by subjecting all first audits by newly licensed audit firms to inspection. The licensing process does not include a pre-license on-site inspection. However, once the AFM has licensed an audit firm, the firm is required to inform the AFM when it has finished its first statutory audit. This statutory audit is then included in the AFM's regular inspection program. In this way, the AFM seeks to ensure that the audit firm complies with the applicable laws and regulations and diminishes the risk that audit firms issue audit opinions of financial statements with insufficient audit evidence.

47. There is also a registration regime for audit firms from outside the EU. They must register with the AFM as third-country audit entities to issue audit reports regarding the annual or consolidated accounts of a company incorporated outside the EU and EEA whose securities are admitted to trading on a regulated market in the Netherlands. Registration only permits this specific

activity and is less extensive than the licensing procedure. The AFM limits itself to establishing the trustworthiness of the policymakers of the third-country audit entity. As of July 2016, there are 13 registered third-country audit firms with 25 employed or affiliated auditors.

48. Individual auditors must possess initial and ongoing qualifications. Individual auditors need to be registered accountants with the NBA. The requirements to be registered consist of practical experience and passing a detailed examination. Auditors are also required to meet continuous education requirements (on average, 120 hours every 3 years).

49. Information about licensed and registered audit firms is publicly available. The AFM maintains a public register for all licensed audit firms, auditors employed by or affiliated with audit firms and of all third-country audit entities and third-country auditors registered with it.

Independence

50. There are extensive and comprehensive auditor independence requirements in place. In the Netherlands, independence requirements for audit firms and auditors can be found in EU Regulation 537/2014,²⁸ the Wta, the Bta, as well as further Regulations issued by the NBA. The two relevant Regulations are the Audit Firms Regulation (Verordening accountantsorganisaties (VAO)) and the Independence Regulation (Verordening inzake onafhankelijkheid (ViO)).

51. The Dutch system, like many jurisdictions, uses the threats and safeguards system for addressing potential independence issues. Both audit firms and auditors are obliged to assess and document their independence. If a situation exists that may cast doubt on or threaten the auditors' independence, additional safeguards must be implemented. If sufficient safeguards cannot be put in place to offset the threats, the auditor and/or the audit firm must withdraw from the engagement. The audit firm and auditor must document these actions. More detailed requirements, including an obligation for annual confirmation by all auditors that they comply with the relevant independence rules and report any perceived threats, also apply.

52. The extensive statutory provisions are supplemented by detailed standards issued by the NBA. The VAO of the NBA includes additional obligations in relation to the audit firm's independence. It, inter alia, obliges audit firms to appoint an officer to supervise compliance with the independence requirements. The NBA ViO also includes a number of independence obligations for all professional accountants involved in assurance engagements. As assurance engagements are broader than statutory audits, this expands the application of independence requirements.

53. The Dutch rules impose stricter auditor rotation requirements than the EU regulation. Under Dutch law, the responsible auditor may only perform the statutory audit of a PIE for a maximum of five consecutive years. The equivalent period under EU Regulation 537/2014 is

²⁸ The regulation contains specific requirements regarding statutory audit of public-interest entities.

seven years. The Netherlands has made use of the member state option to impose the shorter period. A cooling-off period of three years then applies before the auditor may again be responsible for the statutory audit for that PIE.

54. There are extensive rules that seek to ensure strict separation of audit and non-audit services in the Netherlands. There are legislative provisions that limit other relationships between the audit firm and audit clients or between the auditors and the audit clients. These include limitations or prohibitions on providing non-audit services and taking employment as a director or senior officer with the audit client. The EU regulation contains a list of non-audit services that cannot be provided by the PIE-audit firm. The Dutch have used their member state option and implemented additional requirements that result in a strict separation of the providers of audit and non-audit services in the jurisdiction.

55. Audit firms carrying out statutory audits of PIEs are obliged to publish a transparency report. Among other disclosures, the report must include a statement concerning their independence practices and confirm that an internal review of independence compliance has been conducted.

56. The Dutch Civil Code regulates who appoints the auditor. The General Meeting of members or shareholders has the power to appoint the auditor. When it does not give such assignment, the Supervisory Board, or where a Supervisory Board is absent or fails to comply with this duty, the management board is empowered to do so. The ability of the management board to appoint the auditor and/or audit firm will likely be removed with the implementation of new legislation in 2017. With the entry into force of EU Regulation 537/2014, the selection procedure for auditors and audit firms by PIEs has become the responsibility of the audit committee. It must make a recommendation for the **appointment** of a statutory auditor of the PIE.

57. Material changes regarding auditors must be notified to the AFM, but no prompt public disclosure is mandated. If the audit client withdraws the audit assignment, or the auditor and audit firm ends the assignment before the statutory audit has been completed, both the audit firm and the audit client are required to give prompt written notice to the AFM and provide an adequate statement of reasons for the action.²⁹ As a change of auditor is often a red flag indicating significant problems at a public company, IOSCO's expectations³⁰ are that these events (where they involve a public company) should be disclosed promptly both to the regulator and to the public. Companies with securities listed on regulated markets are obliged to make prompt public announcements of any price sensitive information. Unexpected auditor resignations or changes might well be viewed as price sensitive information and thus subject to the prompt disclosure requirement. However, the Netherlands regime does not include any general obligation on unlisted public issuers or on auditors to make prompt public disclosure of such events, and the AFM does not publish the notices it receives. The relevant legislation should be amended to require immediate public disclosure of a change of auditor and the reasons therefore. This should apply (at least) to all public issuers and

²⁹ PIEs are subject to an additional notice requirement and must give the AFM prior written notice of their intention to appoint a particular auditor and/or audit firm.

³⁰ Key Question 6(d) of Principle 20.

consideration should be given to extending the obligation to all PIEs and their auditors. As for the general material change reporting required under the Transparency Directive, the reporting obligation can be drafted to build in the ability to file the notices on a confidential basis in appropriate circumstances.

B. Audit Standards

58. The NBA sets auditing standards and these largely follow the International Standards on Auditing (ISAs). While the most important norms in relation to statutory audits, auditors and audit firms are set by the Dutch legislature, the NBA is responsible for the further regulation of the auditing profession within that legal framework. The NBA issues these through regulations and standards called Further Regulations, such as the Further Regulations regarding Audit and Other Standards (Nadere Voorschriften Controle-en Overige Standaarden, NV COS). The NBA is committed to adopt the ISAs established by the IAASB, unless national laws or regulations require a different treatment, in which case specific Dutch additions or adaptations are made. Adherence to these auditing standards is required. The NBA is also responsible for interpreting the standards for the industry.

59. Proposed auditing standards and regulations are subject to prior public consultation and the standards are subject to approval of the MoF with the advice of the AFM. The NBA publicly consults on the NV COS and on the adoption of new or amended ISAs. These are structured consultations and the process to be followed by the NBA is transparent. The MoF is responsible for the formal approval of the audit standards. The AFM advises both the NBA and the MoF throughout this process. The NBA is obliged to provide the MoF with all information concerning the organization if requested, including an annual report regarding the activities that were carried out and the yearly budget, in order to carry out public oversight.

C. Auditor Oversight

60. The AFM is the responsible regulator for audit and auditors and is independent of the auditing profession. The AFM licenses and supervises audit firms, supervises auditors employed by or affiliated with these audit firms, and registers third-country audit entities. With the implementation of the new EU Directive, the AFM will also be responsible for the registration of audit firms that are approved in other EU member states to carry out statutory audits. It also has authority to take enforcement action in cases of noncompliance. The Wta sets out specific criteria that the majority of the Executive Board members of the AFM must meet to ensure the board is independent from the auditing profession; essentially, they must have had no professional relationship with an auditing firm in the past three years. In practice, all members meet these requirements. However, to ensure the board has the necessary expertise present, one member of the Executive Board has a background in audit.

61. The AFM combines audit and financial reporting supervision in the Audit Quality and Reporting Division. This Division is responsible for audit oversight pursuant to the Wta, as well as the supervision of financial reporting by publicly listed companies. In total, the division has staff equivalent to 49 full-time employees (full-time equivalents or FTEs). The combination of financial

reporting supervision and audit oversight within one division contributes to effective and efficient supervision of listed companies. Issues that arise in the review of an issuer’s financial reporting have led to audit oversight investigations at audit firms and may lead to disciplinary proceedings against individual auditors.

62. The AFM devotes considerable resources to audit oversight. The division has a total of 38 FTEs available for audit oversight activities. Approximately 25 senior inspectors carry out the supervision. Other staff include persons carrying out international activities, policy officers and administrative support staff. All inspectors are non-practitioners. Most are experienced professionals from audit firms (mainly Big 4 firms³¹) and their expertise is reinforced by further training, such as the general education program on supervision within the AFM, “on the job” training, and continuous education for auditors.

63. The AFM is transparent about its auditor oversight activities. As an essential part of its supervisory strategy, the AFM makes public its plans, activities and effects of its activities. The public reporting includes:

- Information in the annual reports and periodic supervision agenda of the AFM;
- Information about regular and thematic inspections through inspection reports on the AFM’s website; and
- To the extent the law permits, the publication of enforcement decisions.

64. The AFM publicly reports the results of its regular inspections and thematic reviews. Since 2014, the AFM has the power to publish its principal findings and conclusions from its inspections at named audit firms, provided these findings and conclusions cannot be traced to anyone other than the audit firm in question; that is, the firms can be named, the audit clients cannot. Previously, the AFM could only publish reports on an aggregate level. This level of transparency better informs shareholders, other stakeholders, and the public of the AFM’s inspection results. As a result, audit firms show more interest in the work and inspection results of other audit firms, thereby creating an incentive for all firms to perform better. In practice, all AFM’s enforcement decisions regarding auditors have been made public on its website.

65. The AFM has wide powers to carry out inspections and investigations. Dutch administrative law does not formally distinguish between inspections and investigations.³² The AFM therefore has the same supervisory powers available for both activities. These include the powers to:

- Enter premises;
- Demand the provision of information;

³¹ The Big 4 are: Deloitte; Ernst & Young; KPMG; and Pricewaterhouse Coopers.

³² Note that the reference in this Technical Note to inspections and investigations follows the Dutch use of these terms. Therefore, an investigation may encompass supervisory activities in addition to just “for cause” inquiries where a breach of the law may have occurred. This is particularly the case when referring to thematic reviews.

- Demand to see a person’s identity card; and
- Inspect business information and documents, to make copies or to take the information and documents.

66. Every natural or legal person is obliged to fully cooperate with a supervisory authority. Staff from the Audit and Reporting Quality Division carry out both inspections and investigations, although in practice different staff carry out inspections and investigations. On-site visits may take place without notice, although in practice, most routine inspection visits are scheduled.

67. The AFM conducts several different types of inspections in support of its oversight responsibilities. The AFM’s auditor inspections strategy includes:

- Regular and thematic inspections at audit firms during which audit engagements as well as elements of the audit firms’ internal quality-control systems are reviewed using a risk-based supervisory approach; and
- Inspections regarding the monitoring of the design and implementation of measures audit firms are putting in place to raise the quality of their statutory audits. This inspection instrument focuses on audit firms’ governance and culture.

68. Regular inspections are conducted to ensure licensed audit firms comply with requirements and the statutory audits they perform are of adequate quality. By law the AFM must inspect each audit firm at least once every six years, or every three years for PIE audit firms. The AFM must also review a selection of audit engagement files as part of its inspections. In practice, the AFM spends most of its resources on PIE audit firms and most of that attention is devoted to the Big 4 audit firms. This is primarily done because PIE audit firms carry out the vast majority of statutory audits in the Netherlands and much of it is done by the Big 4 firms. For example, the Big 4 audit firms conduct approximately 95 percent of all statutory audits on listed companies in the Netherlands. The AFM also carries out inspections at non-PIE audit firms, but has supervisory arrangements with two professional associations to conduct the bulk of these inspections (see below). While the current attention to the Big 4 makes sense from a practical point of view, the overall supervision of the industry would benefit from some additional regular routine inspection attention being paid to the other PIE-audit firms and more spot-checking at non-PIE firms. This additional attention will likely necessitate additional staff and the budget process should take this into account.

69. The AFM uses a risk-based approach to determine which audit engagement files will be reviewed. In advance of inspections, the AFM requests the audit firms included in the inspection cycle to provide a list of all their statutory audit clients, including information regarding the name of the auditor, whether or not an engagement quality-control review (EQCR) or internal quality review was carried out, and what level of risk is attached to the audit in question in the opinion of the audit firm. The actual audit engagement files reviewed are selected to ensure a representative view of the firm’s activities is obtained. Factors taken into account include the:

- Division between PIE audit clients and non-PIE audit clients;
- Range of market segments served;
- Audit engagement files of various auditors;
- Distribution of audits across organizational elements of the audit firm;
- Audit engagement files which have undergone EQCR and audit engagement files which have not;
- Audit engagement files which have undergone internal quality reviews and audit engagement files which have not; and
- Audit file engagements with average or higher-risk profiles.

70. In the most recent Big 4 inspection cycle, the AFM reviewed 10 audit engagement files for each Big 4 firm. These audit engagement files included four PIE audit engagement files, including one health insurer and three other types of PIEs. The inspections at each firm also reviewed six non-PIE audit engagements, including at least one pension fund, one public or semi-public organization and one large undertaking.³³

71. The AFM also reviews the internal quality-control procedures of audit firms during regular inspections. The AFM uses the Common Audit Inspection Methodology (CAIM) for the review of internal quality-control systems of audit firms. This approach has been developed by European regulators within the framework of the European Audit Inspection Group. CAIM was developed to provide an effective inspection program across Europe that addresses expectations from audit firms within Europe that inspections should be carried out consistently, and provide efficiency benefits for less established regulators in Europe.

72. The AFM has a regular inspection program for auditors. The number of regular inspections carried out in the years 2011–2015 (based on start date) is set out below.

Table 7. Netherlands: Regular Inspections Carried Out in the Years 2011–15

| Year | Total | PIE-Audit Firms | Non-PIE Audit Firms |
|------|-------|-----------------|---------------------|
| 2011 | 2 | 2 | 0 |
| 2012 | 39 | 8 | 30 |
| 2013 | 25 | 5 | 20 |
| 2014 | 5 | 5 | 0 |
| 2015 | 4 | 4 | 0 |

Source: AFM.

³³ AFM, *Results on the inspection of the quality of statutory audits at the Big 4 audit firms*, September 2014, pp. 61–62.

73. Regular inspections are supplemented by thematic inspections focusing on key areas of interest across the sector. In recent years, the AFM has carried out various thematic inspections, both with respect to individual audit firms but also in relation to the sector as a whole.³⁴ Reasons for carrying out thematic inspections may include significant developments in the market, changes in legislation, or the importance of a particular area for audit quality. Eight themes have been inspected in the period 2011–2015. The number of thematic inspections carried out in the years 2011–2015 at individual audit firms is presented below.

Table 8. Netherlands: Thematic Inspections Carried Out in the Years 2011–15

| Year | Total |
|------|-------|
| 2011 | 15 |
| 2012 | 4 |
| 2013 | 4 |
| 2014 | 4 |
| 2015 | 8 |

Source: AFM.

74. Identified industry-wise weaknesses in audit conduct are being addressed via a project to promote cultural change at the firms. A number of post-crisis inspection reports identified extensive weaknesses in the conduct of statutory audits, particularly those of PIEs. As a result, the AFM called on PIE audit firms to carry out thorough analyses to determine the root causes of the weaknesses and to implement suitable improvements. Since 2015, the AFM has conducted inspections to assess the design and implementation of the improvement measures audit firms are implementing. The 2015 inspections were carried out at the nine active PIE-audit firms and considered issues such as the governance of the audit firm (the executive board and internal supervision) and whether the public interest is the leading consideration in the firm’s culture, conduct and processes. The AFM also looked at the transparency of the audit firms towards their stakeholders and the extent to which the audit firms’ networks influence quality. A first public report on the monitoring activity appeared in 2015. In 2016, the AFM is conducting follow-up inspections that will consider the implementation of the improvement measures. If the AFM concludes that a PIE audit firm’s design or progress in implementation of improvements is inadequate, the AFM will consider imposing formal enforcement measures to encourage the necessary degree of progress and vigor in design and implementation.

³⁴ Examples of thematic reviews at the sector level are the study on the Critical Ability of Audit Committees with respect to Financial Reporting and Audits—March 2015 and the Market Analysis of Audit Firms 2010–14. Examples of thematic studies at individual audit firm level are the Study on the audit firms’ management of risks associated with corruption in auditing activities (December 2015), as well as the thematic study on statutory audits of housing associations (December 2012).

75. Professional accountancy associations conduct the majority of inspections of non-PIE audit firms. The AFM signed supervisory arrangements with two professional associations: the NBA and the Samenwerkende Registeraccountants en Accountants Administratieconsulenten (SRA), whereby the AFM relies on the quality-control assessments of non-PIE audit firms carried out by the professional associations. The supervisory arrangements have been published in the Government Gazette and are publicly available. The associations have performed approximately 340 reviews and use a review program that parallels that used by the AFM. The associations provide the AFM with information on the outcomes of these quality-control assessments. The NBA and SRA are obliged to inform the AFM immediately when they see serious violations of the auditor's legal duties.

76. The professional associations cooperate with the AFM on matters relating to the associations' auditor review processes, but the AFM lacks express authority to control key issues. The AFM can request the professional associations include a specific audit firm in the review cycle, or include particular focal points in the quality-control assessments carried out. The professional associations generally comply with such requests, although there is no legal obligation to do so. However, the IOSCO principles say that the oversight body must maintain control over these and other key issues.³⁵ The AFM and the professional associations also meet periodically, at both the Board and staff level, to discuss the execution of the supervisory arrangements and to promote alignment between the AFM's inspections and those carried out by the associations. The AFM has the authority to review the quality of the assessments carried out by the associations, and those reviews have recently been instituted. In addition, the AFM continues to have the right to carry out its own inspections at non-PIE audit firms. The AFM should consider renegotiating the agreements with the professional associations to give the AFM express control over key issues such as the scope of the reviews, access to working papers and other information, and follow up of outcomes of the reviews.

77. As a principle, the AFM takes action against audit firms that receive negative quality-control assessments from the professional associations. Action can be taken through formal enforcement (e.g., administrative fines or interim penalty payments) or informal enforcement, such as issuing a private warning or having pointed discussions (called signaling meetings) with the policymakers of the firm. The AFM reviews all relevant information and determines the appropriate follow-up for each individual audit firm. The AFM has an internal policy setting out the factors to be considered in determining the appropriate action.

78. The AFM actively monitors and follows up information from various sources, including mandatory reporting by audit firms. The AFM has an extensive system to monitor and follow up on signals and incidents that have come to its attention. In part, these signals and incidents come from audit firms themselves. Pursuant to the Dutch Civil Code, both audit firms and audit clients must inform the AFM without delay if the audit client withdraws the assignment, or the auditor/audit firms end the assignment before the statutory audit has been completed. In addition, the Audit Firms Supervision Decree (Besluit toezicht accountantorganisaties, (Bta)) obliges audit firms to establish procedures and rules recording and dealing with incidents that have serious consequences for the

³⁵ Principle 19, Key Question 6(a).

integrity of their operations. If such incidents occur, audit firms are obliged to notify the AFM immediately. Signals and incidents also come from audit clients, whistleblowers, investors, other regulators in the Netherlands (such as the DNB), foreign regulators and audit oversight bodies, the media, or any member from the public.

79. All incidents are followed up while all signals are analyzed and a risk-based approach is used to select matters for follow-up. The decision to follow up a matter is driven primarily by the severity of the potential violation and the potential damage to users of financial statements and the financial markets. Follow-up includes one or more of: cross-checking other information available at the AFM; requiring the audit firm provide more information; or inviting the firm’s management board to come to the premises of the AFM to discuss the matter. Often the initial follow-up actions are sufficient to resolve the issue, and the AFM concludes that no further action is needed. If the team is of the opinion that a signal or incident requires further investigation and possibly enforcement action, the management team of the Audit Quality and Reporting Division can decide to formally start an investigation to inquire into the matter in more depth. The findings of the investigation will be presented to the audit firm. The decision to take formal enforcement action against the audit firm is made by the Executive Board of the AFM. In the past years’ investigations have—inter alia—focused on the role of audit firms and/or auditors with respect to signals of fraud and corruption.

80. The AFM carried out 27 investigations from 2011 to 2015. Of the 27 investigations, 19 were carried out at PIE-audit firms and 8 at non-PIE audit firms. The breakdown of investigations by start date is set out below (note that investigations usually extend across more than one year).

Table 9. Netherlands: Investigations Carried Out in the Years 2011–15

| Year | Total | PIE-Audit Firms | Non-PIE Audit Firms |
|------|-------|-----------------|---------------------|
| 2011 | 3 | 2 | 1 |
| 2012 | 13 | 9 | 4 |
| 2013 | 4 | 3 | 1 |
| 2014 | 6 | 4 | 2 |
| 2015 | 1 | 1 | 0 |

Source: AFM.

81. The AFM has statutory authority to take enforcement action against audit firms and factual managers. The Audit Firms Supervision Act provides the AFM the power to:

- Issue an instruction;
- Impose an order for an interim penalty payment;
- Impose an administrative fine;
- Issue a public warning; and
- Withdraw an audit firm’s license.

82. The language in the relevant statute limits the application of the instruction power, order for interim penalty payment, and withdrawal of a license, to audit firms. Administrative fines can be imposed on audit firms and on those individuals who are de facto in control. The AFM cannot exercise these powers against other individual auditors, but can refer matters to the Disciplinary Court (see below).

83. There is a public enforcement policy in place that governs the sanctions sought for violations of laws and regulations. The AFM has a policy that sets out the framework for deciding which sanction would be most appropriate under the specific circumstances of the case. Important drivers in this policy are the severity of the violation, and whether or not the firm has taken appropriate measures to end the violation. Other factors that are taken into consideration include whether management was involved, whether public confidence in markets might be distorted due to the issuance of an inappropriate auditor's report.

84. Individual statutory auditors are subject to disciplinary proceedings conducted by a separate body. If the AFM is of the opinion that an individual auditor should be sanctioned for an act or omission in violation of the provisions laid down in one of the relevant laws, the AFM can file a complaint at the Disciplinary Court for Auditors. The disciplinary actions that the Disciplinary Court can take against individual accountants are laid down in the Accountants Disciplinary Law Act:

- Warning;
- Reprimand;
- Disciplinary fine;
- Temporary exclusion from the accountants' register for a maximum period of one year; and
- Exclusion from the accountants' register.

85. A decision of the Disciplinary Court may be appealed to the Trade and Industry Appeals Tribunal.

86. The Public Prosecutions Office has the authority to pursue criminal action for serious auditor malfeasance. The AFM may file a criminal complaint against an audit firm at the Public Prosecution Office, which makes the decision to open a case against an individual auditor, policymaker or other person.

87. The AFM has used its enforcement powers in the audit sector in an effective manner and has become more assertive over the past few years. The AFM imposed 10 administrative fines against audit firms in the years 2011–2016. Nine of these fines were imposed on PIE-audit firms. Most of the fines were imposed because of the violation of the duty of care, essentially a breach of the statutory obligation to ensure that its auditors comply with their professional standards. Administrative fines have also been imposed for having insufficient quality assurance policies, incorrect internal procedures with respect to the EQCR and the inadequate execution of the compliance officer function. In total, the fines imposed by the AFM in the years 2011–2016 amount to

€7.12 million. In March 2016, the AFM imposed administrative fines on all Big 4 firms for violating the duty of care. The amounts of the administrative fines totaled €6.13 million³⁶ and varied from €845,000 to €2.23 million. All the AFM's enforcement decisions in relation to fines are made public on the website.

88. In the period 2011–2016, the AFM pursued disciplinary cases against six auditors. Five of the disciplinary cases were against auditors employed by or affiliated with PIE-audit firms; one was against an auditor employed by or affiliated with a non-PIE audit firm. In all six cases, the Disciplinary Court imposed a sanction on the auditor involved. The sanctions varied from a warning to an exclusion of the auditor from the accountants' register for six months. Sanctions are entered into the accountants' register. The sanction, the date of imposition and, if applicable, the date of termination of the sanction will be added to all other information on the individual accountant. The register is public and can be found on the website of the NBA.

FUND MANAGEMENT

A. Market Structure

89. While the Dutch CIS market appears to be large compared to the size of the domestic financial system, it is a small part of the Euro area market and an even smaller percentage of the European CIS market. The net assets under management (AUM) of the Netherlands domiciled CIS (including AIFs and UCITS funds), at the end of 2015 were €733 billion,³⁷ which is approximately 7 percent of the total net CIS assets for the Euro area and under 6 percent of the total CIS assets in the EU.³⁸ UCITS funds made up €34.6 billion of the Netherlands domiciled funds AUM (equal to 0.4 percent of the total assets of the European UCITS industry of €8 trillion³⁹) with the AUM of equity funds accounting for €16.75 billion and that of bond funds €15.42 billion.⁴⁰

90. The alternative investment management sector is largely domestic in nature reflecting the structure of the domestic industry that existed prior to the introduction of the AIFMD. The vast majority of Netherlands AIFs are managed by domestic AIFMs.⁴¹ According to 2015 year-end reporting, the total AIF assets managed by the Netherlands collective investment managers were just

³⁶ Making up 83.5 percent of the total imposed over the five-year period.

³⁷ Source: DNB.

³⁸ Source: ECB investment funds balance sheet statistics and European Fund and Asset Management Association (EFAMA).

³⁹ Source: EFAMA.

⁴⁰ Source: DNB. In addition, the AUM of mixed assets funds were €770 million, real estate funds €1.37 billion and other funds €270 million.

⁴¹ Only 8 of 950 NL-domiciled AIFs are managed by other than Dutch AIFMs. Five are managed by EEA-AIFMs and three by non-EEA-AIFMs.

under €700 billion.⁴² Seven hundred forty nine non-Netherlands EEA AIFs have been approved to be marketed in the Netherlands by the end of Q2 2016. No AUM is available for these funds owing to limitations in the present data framework (Table 10).

| Type of Fund | Closed-End | Open-End | Total |
|-------------------|------------|----------|-------|
| Equity Fund | 36 | 484 | 520 |
| Mixed Funds | 2 | 119 | 121 |
| Hedge Funds | 0 | 88 | 88 |
| Bond Funds | 4 | 290 | 294 |
| Real Estate Funds | 498 | 151 | 649 |
| Other Funds | 364 | 155 | 519 |
| Total | 904 | 1,287 | 2,191 |

Source: DNB.

91. Money market funds (MMFs) are not significant in the jurisdiction. There are approximately 25 MMFs domiciled in the Netherlands with AUM estimated to be only €9.9 billion, or less than 1 percent of the Euro area total of €1.096 trillion.⁴³ According to the DNB, MMFs usually have a variable net asset value (NAV), so they pose less of a stability concern than constant value funds. The sector is growing fast (up from €2 billion in 2012⁴⁴) because insurers are increasingly using MMFs as a way of managing their liquidity themselves. The main investors are institutional.

92. Somewhat unusually, domestic institutions own the bulk of the securities issued by Dutch CIS. Dutch retail investors hold less than 5 percent of the value of the securities issued by domestic funds.⁴⁵ Over 90 percent of the securities issued by Dutch CIS are owned by pension funds (80.3 percent) and insurance companies (9.8 percent), and this percentage has been growing over the years. This can be explained, in part, by the fact that the largest CIS managers originally were internal departments of the larger pension funds. The pension funds spun this function out into separate entities and undertook the management of the assets of other pension funds. The assets are managed on a collective (pooled) basis. Prior to the advent of the AIFMD, many of the largest

⁴² Source: DNB. But see the discussion below in paragraph 88 on data issues.

⁴³ Source: ECB.

⁴⁴ Source: ECB.

⁴⁵ Source: DNB.

pension fund managers had an investment firm license under MiFID. As the AIFM license provides more flexibility to provide certain services, these managers have opted for an AIFM license and relinquished their investment firm license.

93. It should be noted that there were some challenges in reconciling and interpreting the available data on CIS. The statistics published by the DNB follow international statistical standards and therefore include both supervised and unsupervised CIS, which does not map directly on the assets held in UCITS funds and AIFs or managed by firms authorized under those directives.⁴⁶ The DNB statistics published on its website also are not reported by NAV, but by total assets and liabilities. The DNB reports the number of CIS by counting each sub-fund; the AFM reports at the umbrella-fund level (resulting in a much smaller number). AIF holdings are not yet reported to ESMA as required under the AIFMD. The system at ESMA for aggregating and analyzing that data is not fully operational, so there is no access to broader statistics on the market yet. Interpretation of the AIFMD reporting template varies, resulting in different reporting of fund strategies and other information (such as leverage) by similar funds. The AFM and the DNB recognize the data shortcomings and are working on cleaning up the information using other sources, including information from ESMA under MiFID. These efforts should be encouraged.

94. The number of authorized domestic fund managers is very small.⁴⁷ As of June 1, 2016, 16 fund managers are authorized to manage and offer units in a UCITS fund in the Netherlands. In total, 42 UCITS funds are established in the Netherlands and managed by Dutch fund managers. Nine hundred two UCITS funds managed by non-Dutch fund managers are also established in the Netherlands. There are 103 licensed AIFMs, of which 87 held a license to manage CIS (other than UCITS) prior to the date the AIFMD became effective. The law converted these domestic licenses to AIFM licenses automatically (see the discussion below in paragraph 138).

B. Regulation

95. The Netherlands has a comprehensive framework for fund management primarily based on the relevant EU framework. The European directives regarding CIS are implemented in the Wft. The main directives are the AIFMD,⁴⁸ which was transposed into the Wft in 2013 and UCITS V Directive, which was transposed in 2016. Delegated regulations regarding CIS are directly applicable in national law. The AFM also has the policy of adhering to the relevant CIS guidelines and recommendations issued by ESMA and IOSCO. With the implementation of UCITS V, essentially the same depositary rules (such as the appointment of a depositary and the requirement for an agreement between the fund manager and the depositary containing specific provisions) are applicable to both AIFs and UCITS funds.

⁴⁶ Given the difference in scope and definitions used in the DNB statistics, a CIS could be included in the DNB statistics, but, at the same time, not identified as managed by an AIFM that should be licensed. Its assets would be included in overall DNB statistics, but not reported as belonging to an AIF.

⁴⁷ Data from the DNB and AFM.

⁴⁸ Directive 2011/61/EU of the European Parliament and of the Council of June 8, 2011 on AIFMDs.

96. The following discussion focuses on the elements of the regulatory framework that are considered most relevant for financial stability. It describes the EU framework in so far as the Dutch requirements are directly based on it. If the Netherlands has additional requirements, those are highlighted separately. The discussion points out the areas in which the regulatory framework is not compliant with the relevant IOSCO principles or standards, or where enhancements are recommended. The manner in which the authorities address compliance with the regulatory framework when authorizing and supervising firms and funds, and monitoring sector risks, is discussed in later sections.

97. There are only two types of CIS recognized by the Dutch regulatory regime: UCITS funds and AIFs. Any CIS that does not qualify as a UCITS fund is an AIF. CIS that are, for example, hedge funds,⁴⁹ property funds, European Venture Capital Funds, European Social Entrepreneurship Funds (EuSEF), and European Long-Term Investment Funds are considered to be AIFs. As noted, many established retail funds that only sold their securities to domestic investors were caught in the definition of AIF, and their managers were required to be licensed under the AIFMD.

98. A UCITS fund is a collective investment vehicle that raises capital from the public and invests in compliance with the UCITS investment restrictions. The main features of a UCITS fund are that it invests in financial assets, applies the principle of spreading risks, has an open-end character, and obtains its investment funds from the public. UCITS funds are subject to diversification requirements and must invest their assets largely in securities that are assumed to be liquid, such as listed equities, bonds and money market instruments. CISs investing in illiquid assets (such as real estate, infrastructure, private equity, or venture capital) generally have more difficulty complying with the conditions applicable to UCITS funds.

99. Both the UCITS Directive and AIFMD include an extensive set of regulatory requirements. The former covers both fund managers and funds, whereas the focus of the AIFMD is on the managers. The UCITS Directive requires funds be managed by EU licensed managers; the AIFMD includes a detailed framework for non-EEA AIFMs and the management and marketing of non-EEA AIFs in the EEA. Further, the UCITS regime is geared toward retail investors, while the professional investors served by AIFs are assumed to be more sophisticated. In the Netherlands, if AIFs within the scope of the AIFMD are offered to retail investors, these funds and their managers are subject to the AIFMD and to additional national investor rules (non-EU harmonized) similar to those in UCITS V, for example additional prospectus requirements. This is the so called “top-up retail regime.”

⁴⁹ There is no set definition of what is considered to be a hedge fund. For reporting purposes, the funds self-identify as hedge funds (or not).

100. Not all managers of AIFs are fully regulated under the AIFMD. Fund managers of AIFs that are only sold to entities related to the manager or fund managers with AUM below the applicable de minimis thresholds⁵⁰ need not be authorized under the AIFMD. However, a registration regime applies to these smaller fund managers domiciled in the Netherlands provided that:

- They only offer AIFs to professional investors;
- They offer their AIFs to retail investors:
- The offers are made to fewer than 150 persons;
- The minimum purchase is greater than €100,000 per person; or
- The units have a minimum denomination of €100,000.

101. These registered AIFMs (“light managers”) are unregulated,⁵¹ save for reporting obligations to the AFM and the DNB.⁵² This regime does not permit the fund managers to offer their AIFs on a cross-border basis within the EU under the passport system but they may, at present, sell to professional investors cross-border following the national private placement regime. A fund manager that widely offers its securities to retail investors must be fully licensed.

102. The AFM and the DNB share responsibility for supervision of the CIS and their managers. The AFM is responsible for market conduct of CIS and their managers while the DNB is responsible for prudential supervision of UCITS management companies, AIF managers and internally managed investment companies (i.e., funds organized as companies that are managed by their own staff). In order to protect the interests of the unit holders, both supervisors monitor the legal structures of CIS at market entry and thereafter during ongoing supervision. The AFM can take action if the formal or actual governance structure is ambiguous to such an extent that it may prevent adequate supervision of the fund manager. This applies also to AIFs, UCITS funds, internally managed investment companies (whether AIFs or UCITS funds), and depositaries. Persons with a ‘qualifying holding’ (10 percent or more) in a UCITS management company domiciled in the Netherlands are obliged to apply for a declaration of no objection (DNO) from the DNB. The DNB’s review prior to issuing a DNO is aimed at ensuring the proposed is fit and financially sound enough to have a significant ownership position in the manager. The DNB also has the power to review qualifying holdings in MiFID investment firms. However, it has no equivalent authority to review holders of qualifying holdings in AIFMs. This authority belongs to the AFM. This and other anomalies between

⁵⁰ The AIFMD de minimis threshold is where the manager manages assets worth less than €100 million for leveraged or open-end AIFs, or less than €500 million for unleveraged AIFs that are not redeemable for at least five years after acquisition.

⁵¹ “Light” managers are not subject to requirements pursuant to the Wft regarding, for example, the suitability and the properness (integrity) of the policy makers, information provision to investors, controlled and sound business operations, moderate remuneration, adequate risk and liquidity management, delegation, maintaining sufficient equity capital, and the requirements with regard to the depositary.

⁵² The light manager must report its identity, the funds managed and the funds’ investment strategies to the AFM. It must report information on instruments held, exposures and significant concentrations to the DNB.

different supervisory regimes should be eliminated and the authorities should work on putting in place suitable amendments (such as amendments at the national level or to the AIFMD) so that the supervisors have equivalent toolkits. For example, significant shareholders of any investment management firm, whether of UCITS funds, individual portfolios or AIFs, should be subject to the same assessments.

Valuation of assets

103. IOSCO expects that there be a proper and disclosed basis for asset valuation and for determining the price of units of a CIS.⁵³ There should be specific requirements to govern the regular valuation of CIS assets. These should apply high quality accepted accounting standards used on a consistent basis to produce fair and reliable valuations. The supervisors should periodically evaluate whether the CIS operators have systems and controls in place to ensure the valuations are fair and the calculation of NAVs are correct. The NAV of the CIS's securities should be published regularly. Pricing errors should be governed by enforceable requirements.

UCITS funds

104. The UCITS Directive leaves the determination of valuation requirements for UCITS funds to the home member state of the fund. It only requires that the rules for valuing the assets and calculating the price of UCITS units be laid down in the applicable national law, in the fund rules, or in the instruments of incorporation of the investment company.⁵⁴ A management company managing a UCITS fund domiciled in another EEA state has to comply with the valuation, accounting and pricing rules of the fund's domicile. Fund managers are responsible for calculating the NAV of the fund and determining the related subscription and redemption prices. To this end, they must have procedures to ensure the proper and accurate valuation of the assets and liabilities of the fund in accordance with the fund rules and prospectus.

105. There are specific requirements for the valuation of the assets of a UCITS fund in the Netherlands. These obligations are incorporated in the Dutch Civil Code and in the recommendations from the Dutch Accounting Standards Board. The Decree on Conduct of Business Supervision Financial Institutions (Besluit Gedragstoezicht financiële ondernemingen Wft, BGfo) also states that the valuation of the assets and liabilities should be performed according to the generally accepted standards. The AFM has general authority to make rules to guide the valuation of UCITS

⁵³ IOSCO Principle 27.

⁵⁴ Further references to fund rules in this note cover also the instruments of incorporation of an investment company.

assets.⁵⁵ No current guidance is in place. However, according to the information provided by the authorities, Dutch GAAP rules on valuation of CIS assets would require market values to be used and are largely consistent with those set out in IFRS.

106. Further, UCITS fund’s business operations must be organized in a manner that ensures the determination of a reliable, correct and consistent NAV for the UCITS fund. No specific rules apply if market prices are not available for an asset. However, the AFM expects the UCITS fund to have a procedure in place to determine valuations in these circumstances. For illiquid investments, an independent expert must perform a valuation of the assets of a UCITS fund at least once a year. All valuation activities must be separate from the other activities of the manager. The depositary of the fund also has a duty to ensure that the value of the units of the UCITS is calculated in accordance with the applicable national law and/or the fund rules. The external auditor and the AFM regularly test the processes used by fund managers to determine the NAV and assess the asset valuation methodology used.

107. The required valuation frequency depends on the type and redemption frequency of a fund. The UCITS Directive specifies that a UCITS fund must have at least two valuation points in a month that are at least two weeks apart. In the Netherlands, the Wft requires that a manager determines the NAV of the units whenever a UCITS fund offers, sells, repurchases, or redeems units. The valuation must be published on the manager’s website without delay. A UCITS fund must include details in the prospectus on how the NAV of the UCITS fund is determined, stating how often the value is determined and the currency in which the NAV of the UCITS fund is determined.

AIFs

108. The valuation requirements for AIFs are based on the AIFMD. AIF assets must be valued and the NAV per unit calculated at least once a year. For open-ended AIFs, the frequency has to be appropriate to the assets held by the AIF and its issuance and redemption frequency. The valuation of financial instruments must take place every time the NAV per unit is calculated, and other assets must be valued at least once a year and every time there is evidence that the last determined value is no longer fair or proper. For closed-ended AIFs, such valuations and calculations also must be carried out in case of an increase or decrease of the AIF’s capital. AIFMD implementing measures include detailed requirements on the content, consistency of application and periodic review of the valuation policies and procedures, use of models to value assets, and review of individual asset values. These requirements do not specify the valuation methods that must be used; they simply require that the valuations follow the rules laid down in the law of the country where the AIF is established and/or in

⁵⁵ The relevant provision says that the AFM may lay down rules concerning the calculation of the risk, the manner of determining the current market value of the underlying assets, the types of obligations that result in a counterparty risk, the consideration of future market developments in the determination, and the methods which may be applied in calculating the risks, partly depending on the nature of the financial instrument in which the investment is made.

the fund's rules.⁵⁶ Dutch AIFs would be subject to the same rules as for UCITS funds—as in, valuation at market value as far as possible—but funds established elsewhere would not necessarily be subject to the same requirement.

109. Fund managers are responsible for the proper valuation of AIF assets, the calculation of the NAV and the publication of that NAV. The fund manager's liability to the AIF and its investors is not affected by the appointment of an external assessor. The external assessor is liable to the fund manager for any losses suffered as a result of the external assessor's negligence or intentional failure to perform its tasks and cannot contract out of this responsibility. This liability regime is part of Dutch civil law. The AIFs' depositories and auditors have similar verification obligations as apply to UCITS (see paragraph 103).

110. The AIFMD also includes requirements to support independence of the valuation function. If the AIFM performs the valuation, those responsible for valuation must be functionally independent from the portfolio management function and the remuneration policy, and other measures must ensure conflicts of interest are mitigated. Any external valuer must be independent from the AIF, the AIFM, and any other person with close links to the AIF or AIFM. The AIF's depository cannot be appointed as an external valuer of the AIF, unless it has functionally and hierarchically separated the performance of its depository functions from its valuation tasks and potential conflicts of interest are properly identified, managed, monitored, and disclosed to the investors. The external valuer is prohibited from delegating the valuation function. The AIFM must notify the competent authority of the appointment of the external valuer. If the valuation function is not performed by an independent external valuer, the AIFM's competent authority may require the manager to have its valuation procedures and/or valuations verified by an external valuer or auditor. The AFM has not yet ordered such a verification.

111. The Dutch CIS regulatory framework requires the use of forward pricing for all types of funds. All AIFs and UCITS funds must be priced using forward pricing, which is consistent with Principle 9 of the IOSCO principles for the Valuation of Collective Investment Schemes. Further, there is a trading system in place in the Netherlands to facilitate purchase and redemption of open-ended CIS funds and Euronext Amsterdam developed a specific service (Euronext Fund Service) to facilitate this trading system. The trading system and associated system for attribution of costs applies to all open end CIS listed at Euronext Amsterdam and all non-listed open-end CIS offering participations in the Netherlands. The price of the executed orders consists of the NAV plus or minus a (limited) spread. This spread may only cover the costs the CIS needs to make in order to facilitate participants entering or exiting the CIS, such as transaction costs of underlying assets and costs as a result of 'market impact' in the case illiquid assets need to be bought or sold. The spread is charged as a percentage of the NAV and needs to be published in the prospectus. The difference between the real

⁵⁶ Commission Delegated Regulation (EU) No 231/2013, Article 2, paragraph 1(b).

costs and the calculated spread are settled within the CIS. CIS managers are expected to periodically assess if the size of the spread is adequate, since it is not supposed to be a source of return, nor a structural loss. Historical pricing is not permitted.

112. MMFs pose no present risk in the Netherlands. The EU has been discussing, but has not yet finalized, a MMF Regulation that may permit constant NAV MMFs subject to certain safeguards.⁵⁷ Recommendation 10 of IOSCO Policy Recommendations for MMFs⁵⁸ strongly recommends against allowing constant NAV funds on the basis that the risks of “breaking the buck” and resulting runs are too high. Given that the aggregate AUM of Dutch MMFs is small, and the fact that most are variable NAV funds, the risks of runs are small. However, the AUM at MMFs are growing fast, so the supervisors should keep a close watch on the funds. Further, pending the finalization of the rules at the EU level, the supervisors should endeavor to be sure any new funds with constant NAVs comply with the safeguards of the IOSCO Policy Recommendations for MMFs.

Treatment of pricing errors

113. The UCITS Directive and AIFMD include only general references to the treatment of pricing errors. The UCITS Directive says the UCITS home member state rules apply to errors in the NAV calculation and related investor compensation. AIFMD implementing measures require an AIFM to ensure that remedial procedures are in place in the event of an incorrect calculation of the NAV.

114. Dutch fund prospectuses must contain disclosure relating to pricing errors and compensation of investors for errors. According to the BGfo, the prospectus of a UCITS fund must state the circumstances under which and the manner in which unit holders are compensated for an incorrectly calculated NAV, and in particular, for any maximum percentage of divergence from the correctly calculated NAV that applies to the compensation. Under the “top-up retail regime,” open-ended AIFs offered to retail investors must also include this information in their prospectuses. Compensation for errors is not specifically required by law, but the AFM expects that the administrative organization and internal controls of the fund manager of a UCITS fund, a UCITS fund or a depositary of a UCITS fund will incorporate an extensive procedure to compensate investors for errors in the calculation of the NAV.

⁵⁷ The EC published a proposal on the regulation of MMFs on September 4, 2013. The European Parliament’s position on the proposal was reached on April 29, 2015, and the Council of the EU issued its final opinion on June 17, 2016. Currently, it is therefore not clear whether and when the regulation may be adopted. If a final agreement is reached, it is unlikely that any new regulation would be operative before 2019.

⁵⁸ Recommendation 10: “MMFs that offer a stable NAV should be subject to measures designed to reduce the specific risks associated with their stable NAV feature and to internalize the costs arising from these risks. Regulators should require, where workable, a conversion to floating/variable NAV. Alternatively, safeguards should be introduced to reinforce stable NAV MMFs’ resilience and ability to face significant redemptions.”

Managing the redemption risk

Risk and liquidity management generally

115. IOSCO principles expect that CIS managers/operators be required to have a risk management framework in place. The risk framework should be supported by appropriate and documented policies and procedures and by an independent risk management function, proportionate to the size, complexity and risk profile of the CIS.⁵⁹ This general statement has been supplemented by additional guidance for CIS on liquidity management standards and principles on suspension of redemptions.⁶⁰

116. UCITS funds are subject to investment limits and the fund manager is required to manage and measure the funds' risk on a continuous basis. Detailed investment limits are set out in the UCITS Directive. The Directive also requires the manager to employ a risk management process that enables it to monitor and measure the risk of the positions and their contribution to the overall risk profile of the portfolio at any time. The UCITS Implementing Directive includes additional requirements on due diligence in the selection of investments and on risk management and measurement. The risk management policies and procedures must allow the manager to assess the exposure of each UCITS to the full range of risks, including liquidity risks. The competent authority must review the risk management policy when authorizing the manager and on an ongoing basis. Any material changes to the policy must be notified to the competent authority. A UCITS fund manager must adopt effective arrangements, processes and techniques to establish, implement, and maintain a documented system of internal risk limits, including for liquidity risk, where relevant. The manager must employ an appropriate liquidity risk management process to ensure that each UCITS complies with its redemption obligations and, where appropriate, conduct stress tests about the UCITS liquidity risk under exceptional circumstances. The liquidity profile of the UCITS must be appropriate to the disclosed redemption policy. The match between liquidity of the investments and the fund's redemption policy is carefully checked by the AFM as part of the review process for a new fund. The Dutch system does not impose any additional requirements or provide additional guidance on risk management at UCITS funds, although they have the authority to do so. Also, while the supervisors may ask for reports from UCITS managers on their risk management process or outputs from stress testing, this information is not routinely required to be filed with the supervisors.

117. The above regulatory requirements on liquidity risk management are extensive, but some additional requirements would further enhance the strength of the framework. UCITS fund managers are only required to conduct liquidity stress tests to assess liquidity risk in exceptional circumstances. Principle 14 of the IOSCO Principles for Liquidity Risk Management for CIS requires that appropriate liquidity risk assessments also should be carried out for normal scenarios. The regulatory framework would be enhanced by requiring UCITS fund managers to conduct liquidity stress tests under both normal and stressed scenarios. This would also bring the requirement into

⁵⁹ Principle 24, Key Questions 2(e) and (f) and related Explanatory notes.

⁶⁰ IOSCO, Principles of Liquidity Risk Management for Collective Investment Schemes, March 2013, and Principles on Suspensions of Redemptions in Collective Investment Schemes, January 2012.

alignment with that in the AIFMD (see below). The authorities are encouraged to seek enhancements to the liquidity risk management requirements for UCITS fund managers, either through changes to the UCITS Directive or through their own measures. Routine reporting of liquidity data and stress testing results by UCITS fund managers might also be pursued.

118. The risk management requirements applicable to AIFMs are complemented by detailed obligations for liquidity management systems and procedures. The AIFMD includes extensive requirements on risk management at AIFMs. For example, AIFMs are required to functionally and hierarchically separate the risk management functions from the operating units (including portfolio management); implement adequate risk management systems in order to identify, measure, manage, and monitor all risks relevant to each AIF; and review of their risk management systems at least once a year. Further, an AIFM must ensure that the investment strategy, liquidity profile and redemption policy of each AIF it manages are consistent. It is required to employ an appropriate liquidity management system and to adopt procedures that enable it to monitor the AIF's liquidity risk and to ensure that the liquidity profile of the AIF's investments complies with its underlying obligations. It must also regularly conduct stress tests under normal and exceptional liquidity conditions, which enable it to assess and monitor the liquidity risk of the AIF. Further, the AIFMD requires the AIFM to disclose to investors a description of the AIF's liquidity risk management, including the redemption rights both in normal and in exceptional circumstances, and the existing redemption arrangements with investors. AIFMs must also identify, manage and monitor conflicts of interest between redeeming and remaining investors and between the AIFM's incentive to invest in illiquid assets and its redemption policy. The Dutch system does not impose any additional requirements or provide additional guidance on risk management for AIFs.

Special tools

119. IOSCO's Principles for Liquidity Risk Management contemplate the use of specific tools and exceptional measures to manage liquidity in appropriate circumstances. These tools and measures include exit charges, limited redemption restrictions, gates, dilution levies, in specie transfers, side pockets or suspension of redemptions. The available tools and exceptional measures should be fully disclosed to investors, and only be used where fair treatment of investors is not compromised and where permitted by the laws applicable to the CIS.

120. AFM has banned side pockets, except where a separate sub-fund is created for the purpose of liquidating the assets. Side pockets are banned because they create an incompatible closed-end part within an open-end fund. Starting in 2010, the AFM has not permitted new funds to be established using an open-end structure if the fund is intending to invest in illiquid securities.

121. Pricing tools may be used to address first mover advantage in single-priced funds if they are disclosed in the prospectus. These tools would pass costs onto the investors exiting the fund rather than the remaining investors. Swing pricing, in which the unit price is determined by calculating the NAV for the fund before subscriptions and redemptions, and then adjusting it by a pre-determined amount (the swing), has been permitted. It would only be available on short notice if it is clearly explained in the prospectus of the fund. Effectively, the trading system at Euronext

Amsterdam for listed open-ended funds (discussed in paragraph 108) uses swing pricing. As the prospectus of a fund must provide information regarding the way the entry and exit costs are calculated, imposing an exit charge that differs from what is mentioned in the prospectus is considered a change in the terms and conditions applicable between a CIS and the unit holders. A change of this type would have to be published on the website of the fund manager and likely would not be enforceable against an investor until a suitable notice period has passed. In the meantime, the fund would be required to allow investors to redeem under the existing terms.⁶¹ Other types of pricing tools, such as dilution levies,⁶² might be permitted but they would be subject to the same prior disclosure requirements.

122. There are no specific requirements on the suspension of redemptions in the UCITS Directive or AIFMD. The UCITS Directive provides that a UCITS fund may, in accordance with the applicable national law and the fund rules, temporarily suspend the redemption of its units if the suspension is in the interest of unit holders. The competent authority and investors must be informed about any suspension. The suspension may only continue for as long as is justified in the interest of the unit holders, with a formal review of the suspension to be held at least every 28 days. Under the Dutch regime, the prospectus must describe the scenarios in which a suspension of pricing and redemption may take place. The AFM only permits these to be exceptional circumstances, such as where there are circumstances beyond the control of the fund or fund manager that make a correct valuation or repurchase impossible, such as if there are political, economic, military, or monetary situations that hinder the fund manager in calculating the NAV with sufficient accuracy. The AFM may intervene, on a case-by-case basis, if it views the suspension of repurchase/issue as not in the interest of the investors.

123. The AIFMD permits the use of limited redemption arrangements, which are important to manage an AIF's liquidity risk from less liquid portfolio assets. The fund rules may contain restrictions on the right to redeem units. Investors must be provided with a description of the AIF's liquidity risk management, including the redemption rights both in normal and in exceptional circumstances, and the existing redemption arrangements with investors.

124. The AFM has authority to require the suspension of redemptions. Under the AIFMD, the competent authority must have the power to require the suspension of the issue, repurchase or redemption of AIF units in the interest of the unit holders or of the public. The UCITS Directive does not expressly require the competent authority to have similar powers. However, in practice, the AFM expects to be able to agree with the fund manager on the proper course of action should circumstances suggest a suspension is needed. If the problems are market-wide, the AFM may make

⁶¹ If a proposed amendment to the terms and conditions entails a reduction of the unit holders' rights or security or the imposition of charges on the unit holders, the law prevents the amendment to be invoked towards the unit holders before a month (or more) has elapsed since the publication. Unit holders may withdraw under the usual terms and conditions during this notice period.

⁶² A separate charge is made to investors buying or selling fund units and paid into the fund to mitigate the effects of dilution on remaining unitholders.

temporary orders to improve the orderly and transparent financial market processes. The DNB is vested with the power to act in the interest of financial stability, such as when large and uncontrolled market movements occur that result in severe unrest in the financial sector.

Use of leverage

125. The EU regulatory requirements on the use of leverage in UCITS funds and AIFs differ materially. A UCITS fund's global exposure has to be calculated using either the commitment approach or the Value-at-Risk (VaR) method. Borrowing is not taken into account when determining the leverage of a UCITS fund, but UCITS funds are permitted to borrow only up to 10 percent of their NAV. The UCITS Directive limits a UCITS fund's global exposure from derivative instruments to 100 percent of the total net value of the UCITS portfolio. The AIFMD defines leverage as any method by which the AIFM increases the exposure of an AIF, whether through borrowing of cash or securities, leverage embedded in derivative positions or by any other means. The AIFMD does not set maximum leverage limits; it requires AIFMs to set leverage limits in respect of each AIF they manage and disclose these to investors. The Dutch supervisors do not impose any specific leverage limits on AIFs. Leverage must be calculated using two methods: the gross method and the commitment method. The overall leverage of an AIF is expressed as a ratio of the AIF exposure to its NAV. The four leverage calculation methods are described in more detail in Box 1.

126. The leverage discussions and calculations are complicated by a lack of an agreed definition of what constitutes leverage in funds. There is also a mismatch between the definitions set out in the directives (including how NAV is calculated) and how leverage is used and managed in practice. There does not appear to be any consensus between supervisors in different jurisdictions or among the industry participants. The DNB has two projects (thematic investigations) ongoing related to leverage: (a) to improve the data quality of the leverage information; and (b) to develop a conceptual framework to apply to these issues, which will allow it to assess the need for further measures. The latter is being done in cooperation with the ECB. The results are expected at the end of 2016. Several international groups, including IOSCO, are also working on the issues. The AFM contributes internationally to this issue, for instance, via IOSCO Committee on Investment Management that operates in close cooperation with the Financial Stability Board.

127. While the AIFMD requires AIFs' leverage to be reported to the competent authorities on a regular basis, the reporting requirements on UCITS funds' leverage are much more limited. UCITS fund managers must only report annually on the types of derivative instruments used for each managed UCITS, the underlying risks, the quantitative limits, and the methods which are chosen to estimate the risks associated with the derivative transactions. UCITS fund managers are currently required to notify the details of their derivative risk management process annually to the supervisors.

Box 1. Leverage Calculation Methods

UCITS Directive

The standard methodology for the calculation of a UCITS fund's exposure is the **commitment approach**. The global exposure under the UCITS Directive only takes into account financial derivatives and securities financing transactions (SFTs) that generate leverage. UCITS funds can apply netting and hedging arrangements to reduce their global exposure.

Under the commitment approach, leveraged is calculated as the sum of:

- Derivatives: sum of the equivalent positions in the underlying assets after netting and hedging arrangements; and
- SFT: market value of the collateral received (including cash) when reinvested.

UCITS funds should use a **VaR** method (relative VaR or absolute VaR approach depending on the investment strategy of the fund) when (i) they engage in complex investment strategies which represent more than a negligible part of the fund's investment policy; (ii) they have more than a negligible exposure to exotic derivatives; or (iii) the commitment approach does not adequately capture the market risk of the portfolio. VaR is to be calculated as follows:

Relative VaR

- VaR of the UCITS fund's current portfolio (which includes derivatives) compared to the VaR of an unleveraged reference portfolio; and
- The portfolio VaR limit is twice the VaR of the unleveraged reference portfolio.

Absolute VaR

- Risk limited to maximum of 20 percent of NAV; and
- Specific requirements are imposed regarding confidence interval, holding period and effective observation period of risk factors.

AIFMD

AIFMs must calculate their exposures using two different methods.

The **commitment method** is similar to the commitment approach for UCITS, but AIFMs have to include all positions, not just derivative positions.

Leverage under the AIFMD commitment method is calculated as the sum of:

- Direct positions: at accounting value;
- Derivatives: the sum of the market value of the equivalent position in the underlying asset (after netting and hedging);
- SFT: market value of the collateral received (including cash) when reinvested; and
- Reuse of cash borrowing: the higher of the market value of the investment realized or the total amount of the cash borrowed.

The **gross method** requires the calculation be based on the absolute values of the assets of the AIF added up without applying netting and hedging arrangements. Financial derivative instruments are converted into the equivalent position in the underlying asset using conversion methodologies set out in the AIFMD Regulation. Cash and cash equivalents are excluded for the purpose of the calculation.

Leverage under the AIFMD gross method is calculated as the sum of:

- Direct positions: at absolute value; minus
- Cash equivalents.

128. The absence of an internationally agreed standard for determining an investment fund's leverage is a major regulatory gap. Market participants are concerned about the potentially misleading leverage information that the current calculation methods may produce. Further, the lack of an agreed definition makes compliance in a regional marketplace very difficult. Also, in order to allow authorities to have a clearer overview of the use of leverage by investment funds, a common method for the calculation of investment fund leverage would be useful.⁶³ The DNB projects in this area are excellent initiatives and it is hoped that these will lead to the development of a practical and common approach to measuring investment fund leverage. The supervisors are also encouraged to contribute to international work to harmonize the leverage calculation method.

Depositories and safekeeping of client assets

129. IOSCO principles⁶⁴ require adequate segregation of an investment fund's assets from the assets of the fund manager, custodian and other custody clients. The safekeeping of fund assets is best entrusted to a completely independent depository. If the use of an independent depository is not possible, special legal or regulatory safeguards should be applied to ensure the protection of client assets. Client assets should be identified to the depository and to any sub-custodian it uses. Investment fund assets should be segregated from: (i) the assets of the fund manager and its related entities; (ii) the assets of the custodian/sub-custodian throughout the custody chain; and (iii) the assets of other investment funds and other clients of the custodian throughout the custody chain (unless investment fund assets are held in a permissible omnibus account). With regards to the independence of the depository/custodian, IOSCO standards highlight some safeguards that may be used to enhance the independence of a related-party custodian, such as additional disclosure or audit requirements.⁶⁵

130. The UCITS Directive and AIFMD require the appointment of a depository for each UCITS fund and AIF. As a general rule, a depository must have its registered office or a branch in the same country where the fund is domiciled. However, a non-EEA AIF's depository may be established in the AIFM's home state. The competent authority of the UCITS home state must approve the depository to act as a depository for a fund domiciled in that EEA state. There is no such requirement in the AIFMD; however, the Dutch supervisors have to approve all depositories used by the Netherlands domiciled funds. The AIFMD and UCITS V Directive require a detailed written contract between the fund manager and depository that includes provisions that regulate the flow of information necessary for each party to perform their roles. The Netherlands regime imposes the same authorization

⁶³ This was also recommended in the IMF Global Financial Stability Report, October 2015 (Chapter 1, p. 37).

⁶⁴ Principle 25, Key Issues 3 and 4 and Key Questions 7 and 8 and IOSCO Standards for the Custody of Collective Investment Schemes' Assets.

⁶⁵ The IOSCO list of restrictions that seek to ensure the protection of investment funds assets in such situations may include: additional disclosure requirements; additional capital requirements; designating specific persons who are permitted to access the CIS assets; and requiring an independent public accountant to verify the assets held and to conduct a certain number of examinations without giving prior notice to the responsible entity.

requirements on depositaries for UCITS funds and AIFs. A depositary must be suitable, which includes an assessment of its executives' fitness and propriety and the depositary's capacity to carry out its duties for the type of assets to be held and transactions to be undertaken by the fund.

Prudential requirements

131. The Dutch prudential requirements for UCITS depositaries are the same as those of the UCITS V Directive. The UCITS V Directive requires a depositary to be a national central bank or an authorized credit institution. It may also be another type of authorized entity permitted to carry out depositary activities subject to minimum capital adequacy requirements and specific business-conduct and operational requirements, as permitted under national law. Under the Dutch rules, a bank may be a depositary without a license from the AFM. A MiFID investment firm⁶⁶ subject to the €730,000 capital requirement that meets the "own funds" requirement of the Capital Requirements Regulation⁶⁷ can be authorized to act as a depositary of a UCITS fund or an AIF.⁶⁸

Safekeeping and segregation of fund assets

132. The AIFMD and UCITS V Directive contain segregation and safekeeping/record keeping requirements applicable to all AIF and UCITS assets. The safekeeping duties under UCITS V and the AIFMD are largely aligned and the segregation and cash flow monitoring responsibilities are largely similar. Financial instruments held in custody must be registered in segregated accounts and clearly identified as belonging to the fund at all times. Legal title to a safe custody asset can be registered in the name of another party or the depositary if that is the only option, the assets are subject to the law or market practice of a foreign jurisdiction, and the depositary has notified the client in writing. Financial instruments that can be held in custody but that cannot be physically delivered to the depositary must be registered in a segregated financial instruments account opened in the name of the fund or the manager acting on behalf of the fund. The AIFMD and UCITS V a financial instruments account may be opened in the name of the manager acting on behalf of the fund. However, the AFM is stricter and requires that a financial instruments account may be opened only in the name of the fund or the legal owner of the fund, in order to properly guarantee the asset segregation. Up-to-date records have to be kept of other assets.

133. One of the principal differences between the two regimes relates to re-use (re-hypothecation) of fund assets. A UCITS depositary (or its delegate) is prohibited from re-using the assets that it holds in custody for its own account. The re-use of assets for the account of the UCITS is subject to conditions, including that the re-use be for the benefit of the UCITS and in the interests of unit holders and that the transaction is covered by high quality, liquid collateral received by the UCITS

⁶⁶ In addition to investment firms, some other firms can act as depositaries, but they are subject to the same capital requirements as investment firms.

⁶⁷ Regulation (EU) No 575/2013 of the European Parliament and of the Council of June 26, 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ 2013, L 176.

⁶⁸ The investment firm must also be allowed under its license to provide ancillary services such as safekeeping and administration of financial instruments for the account of clients.

under a title transfer arrangement, the market quality of which at all times amounts to at least the market value of the reused assets plus a premium. Under the AIFMD, re-use arrangements can be entered into with the consent of the fund.

134. The Directives include specific requirements on delegation of safekeeping tasks by a UCITS or AIF depositary. Only safekeeping tasks may be delegated. The depositary must be able to demonstrate there is an objective reason for the delegation and must exercise due diligence and care in the appointment of the sub-custodian. The sub-custodian⁶⁹ must be subject to effective prudential regulation and supervision and to external periodic audit to ensure that the financial instruments are in its possession. It must segregate the assets of the depositary's clients from its own assets and those of the depositary in such a way that they can, at any time, be clearly identified as belonging to clients of a particular depositary. The delegate has to keep such records and accounts as are necessary to enable it at any time and without delay to distinguish assets of the depositary's fund clients from its own assets, assets of its other clients, assets held by the depositary for its own account, and assets held for clients of the depositary that are not funds. Under UCITS, the sub-custodian must take all necessary steps to ensure that, in the event of its insolvency, the assets of a UCITS fund held in custody will be unavailable for distribution to the sub-custodian's creditors (i.e., bankruptcy remote). The AFM has confirmed that this treatment will apply on the bankruptcy of a Dutch depositary. Under the AIFMD, the depositary agreement must contain an obligation on the depositary to notify the AIFM if the depositary becomes aware that segregation of assets is not, or no longer sufficient, to ensure protection from insolvency of a sub-custodian.

135. The Netherlands requirements for safekeeping match those of the EU and are consistent with IOSCO's expectations.⁷⁰ However, the interpretation of some of the segregation requirements under the AIFMD has been subject to debate and with the implementation of similar rules in UCITS V, the need for a common approach has increased. ESMA published a consultation paper on December 1, 2014 on guidelines on asset segregation under the AIFMD that covers the interpretation of these requirements. The industry strongly objected to the proposals. On July 16, 2016, ESMA issued a further call for evidence asking for more input and broadening the scope of the consultation to cover asset segregation under UCITS V. Given the cross-border nature of the investment fund industry, it is important that the Dutch authorities contribute to the EU discussions on the development of a common approach. Differing interpretations would lead to operational challenges in custody arrangements and facilitate regulatory arbitrage.

Depositary independence

136. AIFMD and UCITS V Directive include detailed rules on the depositary independence, but stop short of requiring the depositary to be at arm's length to the fund or its manager. They prohibit a depositary from carrying out activities with regard to a fund or its manager, unless the depositary has functionally and hierarchically separated the performance of its depositary tasks from

⁶⁹ The fund manager cannot act as a sub-custodian.

⁷⁰ Key Question 7 of Principle 25 of the IOSCO Principles and Standards for the Custody of CIS Assets.

its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed. The AIFMD also specifically prohibits an AIF's prime broker from acting as the AIF's depositary, unless the prime brokerage and depositary functions are separated and conflicts of interest are properly identified, managed, monitored, and disclosed. The AFM has extended this requirement to apply to a UCITS fund's prime broker. Neither directive requires the depositary to be an unrelated legal entity.

137. The Netherlands framework has no additional mandatory requirements on depositary independence beyond those set out in EU legislation. If the depositary is a related party of the fund manager, the AFM expects that extensive procedures will be in place to ensure the depositary is able to exercise its duty as a depositary independently. These are investigated in detail at the time the AFM receives notice of the appointment of the depositary and the use of a related-party depositary has been denied when the AFM is of the view that insufficient independence structures were in place. However, no guidance on the AFM's expectations in this regard has been published.

138. Further enhancements would be beneficial to the depositary independence requirements. The segregation and safekeeping requirements comply with IOSCO principles and standards. In contrast, the depositary independence requirements of UCITS V Directive are less stringent than IOSCO would expect and many member states already require enhanced independence from their local depositaries. The AFM is encouraged to assess the risks from the use of related-party depositaries and consider requiring additional safeguards along the lines proposed by IOSCO. In the meantime, providing transparent guidance to the marketplace on what is expected to be in place would be helpful.

Depositary liability

139. UCITS V and the AIFMD provide for a strict liability regime governing the loss of financial instruments held in custody. In the event of a loss by a depositary (or its delegate) an obligation is imposed on the depositary to replace the financial instrument or pay the value to the fund without undue delay. A depositary can only avoid this strict liability standard where it can prove that the loss was as a result of an external event, beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. Under UCITS V a depositary cannot contractually discharge its liability in the case of the loss of assets by its delegate, meaning that the loss must be borne by the depositary rather than by the delegate. The AIFMD allows the depositary to contract out of liability if, with the AIF's agreement, the written contract between the depositary and the delegate expressly transfers the liability to the delegate and makes it possible for the AIF to make a claim against the delegate for the loss. More generally, the depositary will also be liable to the UCITS and the investors of a UCITS if a loss is suffered as a result of the depositary's negligence or intentional failure to properly fulfill its obligations under UCITS V. Similar depositary liability for losses is imposed under the AIFMD. All UCITS investors may invoke the liability of the depositary directly or indirectly through the management company, irrespective of the legal structure of the fund. Under the AIFMD the right to invoke claims depends on the legal nature of the relationship between the depositary, the management company and the investors.

C. Authorization

Managers and depositaries

140. The AFM puts significant effort into the authorization process in order to reduce the risk of insufficient governance. As noted, UCITS fund managers must be authorized and AIFMs must be either authorized or registered. In its licensing and other processes relating to these managers, the AFM emphasizes governance matters. These include requirements such as functional and hierarchical separation of portfolio and risk management functions, checks and balances within managers, reporting lines of directors and high-ranking officers (such as the heads of risk, control, audit, legal, and compliance functions), and relationships with third parties (such as depositaries and custodians). Conflicts of interest are another focus.

141. The authorization and ongoing supervision process for AIFMs has been challenging. Eighty seven domestic fund managers that were licensed before July 22, 2013 automatically had their licenses converted to AIFM licenses on the implementation of the AIFMD. Most of these were domestic fund managers that managed funds only sold in the Netherlands. While they were subject to a detailed authorization process when they were originally licensed to sell domestic funds and were required to take all necessary measures to comply with the new AIFMD regime, they were not subject to any special review prior to the conversion of their licenses. Many of these managers were unprepared for the requirements under the AIFMD and the enhanced level of supervision they would face. To address the potential gaps between the old domestic rules and the new AIFMD requirements, special risk-based attention has been given to AIFMs with converted licenses to ensure they fulfill the required obligations, with particular attention being paid to the depositary arrangements and the segregation of client assets. For example, an enhanced compliance review is done when one of these managers applies to manage a new fund or gives notice of a material change, such as a change in management, an acquisition or change in depositary. Approximately 50 percent of these converted managers have been subject to such an enhanced review. The AFM is intending to review the remaining managers⁷¹ in 2017 via thematic and risk-based reviews.

142. There is a comprehensive review process carried out by a dedicated AIFM team when assessing an application for a license or seeking to register a new fund. Any applicant for authorization as an AIF manager that applied after July 22, 2013 has been subject to a comprehensive review process covering all aspects of the requirements. A substantial number of new applications have been refused or withdrawn. The AFM has received a total of 24 depositary notifications since 2015 to the end of July 2016. Two hundred ninety three AIFs were registered since 2014.

⁷¹ According to the AFM, most of these firms manage relatively small funds.

Table 11. Netherlands: AIFMD: Number of New Licenses and Registrations

| Year | AIFM Licenses Granted | Registrations of "Light Managers" | AIF Registrations |
|--------------------|--------------------------|--------------------------------------|-------------------|
| 2014 | 13 ^{1/} | 108 | 150* |
| 2015 | 12 | 82 | 100 |
| 2016 ^{2/} | 4 | 39 | 43 |

Source: AFM.

1/ Does not include the managers (and their AIFs) that were "pre-AIFMD" domestically licensed and whose licenses were automatically converted into AIFM licenses on July 22, 2014.

2/ The numbers for 2016 reflect only the first half of the year.

143. The pool of fund managers in the jurisdiction is small. As of June 1, 2016, 16 fund managers are authorized to manage and offer units in a UCITS fund in the Netherlands. Of the 944 UCITS funds established in the Netherlands, 42 are managed by Dutch fund managers and 902 by non-Dutch fund managers. During the last 3 years the AFM has granted 6 UCITS fund manager licenses and 17 requests for registration of UCITS funds.

144. The authorization process is largely based on reviewing documents that are submitted on line and/or on paper. Additional contacts with the applicant are initiated as needed. The application process for new AIF or UCITS manager licenses requires submission of extensive information on matters including fitness and propriety of the policy makers; policies and procedures for the sound conduct of business; control structure; conflict of interest policies and disclosure; depositary and safekeeping of assets; capital adequacy and solvency. The application package is filed with the AFM and automatically provided to the DNB. The AFM is lead supervisor on the licensing process and licenses are granted when all requirements are fulfilled and any additional questions are answered satisfactorily. The DNB carries out its prudential assessments of the managers and depositaries independently (but with full communication with the AFM on issues) and provides the AFM with its "prudential advice" on whether the applicant meets the prudential requirements once that process is completed.

145. The review of an application at the AFM is risk-based. When reviewing a license application or a new fund registration, all materials are reviewed but areas seen to give rise to significant risks are given particular attention, such as:

- The soundness of matches between the types of invested assets (liquidity profiles and complexity of assets), redemption frequencies, available restrictions managers can impose on redemption rights, and the type of investor that is targeted and their investment horizon;
- The policies that may have a direct or indirect impact on risk profiles and risk-taking behavior, e.g., remuneration, conduct of business, risk management, and conflicts of interest policies. For example, when liquidity management policies are reviewed, the ability of the fund to restrict redemptions in appropriate circumstances is considered;

- The governance, such as a functionally independent risk function and fit and proper day-to-day management; and
- The role of the depositary.

146. For depositaries, the AFM focuses on the content of the depositary agreement between the fund manager and the depositary. Every time a fund manager applies for the registration of a depositary, the depositary agreement will be fully reviewed to ensure it complies with the rules as laid down in the directives and implementing regulations. The AFM also reviews the operating memoranda, service or operating level agreements and all other documents that are provided to the AFM and checks if these comply with the law. Further, the persons who effectively conduct the business of the depositary must be of sufficiently good repute and sufficiently experienced (i.e., fit-and-proper testing of their day-to-day management). If new instruments are to be held by the depositary, its capacities are reassessed to ensure it can handle the new demands.

147. The DNB has a comprehensive application review process that seeks to ensure both that initial capital is met and that the firm will be operated in a sound and prudent fashion. The DNB does its due diligence on the whole package of information and its assessments go beyond looking at whether the initial capital requirements are met. The reviewers also assess, for example, the reasonableness of the business plans and forecasts, and what would happen to the capital of the firm if the forecasts were not met. The initial capital presented is expected to be sufficient to cover the minimum required plus the expected losses in the initial years of operation. The DNB also assesses risk management, liquidity management and leverage management as applicable. The DNB follows up with the applicant for further information, as needed, and when gaps are identified. As noted earlier, the DNB also reviews the fitness and financial soundness of anyone who holds or proposes to hold more than 10 percent of the equity of an investment firm or the manager of a UCITS fund. It has no equivalent authority to review qualified holdings of AIFMs. This authority belongs to the AFM (see also the discussion in paragraph 99).

148. Under the UCITS Directive, member states have the discretion to determine whether, and subject to which conditions, delegation of investment management is permitted. The fund manager may delegate one or more of the functions it has to perform as a fund manager in compliance with the requirements set out in the UCITS Directive. However, outsourcing of the investment policy is not permitted. The UCITS Directive prevents delegating investment management to the depositary or to any other person with potential conflicts of interest and requires the delegate to be authorized for asset management, prudentially supervised and, in the case of a non-EEA person, there must be cooperation arrangements in place between the relevant authorities. Delegation must not prevent effective supervision or the fund manager from giving further instructions to the delegate or from withdrawing the mandate.

149. AIFMD includes similar, but not identical, delegation requirements. An AIFM must provide a detailed description of its entire delegation structure to its competent authority. Subject to the approval of the competent authority of its home state, an AIFM can delegate portfolio management or risk management. Several conditions must be met, such as the AIFM must be able to provide objective reasons to justify its entire delegation structure; the delegate must have sufficient resources to perform such task; for portfolio and risk management the delegate must be authorized and subject to supervision; and the delegation must not prevent effective supervision. Delegation to such persons is not permitted under the UCITS Directive. Sub-delegation requires the consent of the fund manager and notification to the competent authority. The AIFMD specifically prohibits delegation and sub-delegation of portfolio management or risk management to a delegate of the depositary that is not functionally and hierarchically separated. The AFM does not apply any requirements in addition to those set out in the AIFMD.

150. Common requirements apply under both Directives regarding notice of delegation, liability and limits to delegation that are consistent with IOSCO expectations. A fund manager is also obliged to inform the AFM of its intention to delegate any function and the disclosure document (prospectus) for the fund must contain information about the delegates. The liability of the fund manager is not affected by the delegation, and it remains responsible for the proper operation of the fund. Finally, a fund manager must not delegate its functions to the extent that it becomes an empty shell (or “letter box entity”).

151. AIFMD includes additional requirements on delegation to non-EEA persons. A written agreement must exist between the relevant competent authorities covering at least access to information and documents, the ability to carry out on-site inspections and enforcement cooperation. The non-EEA country also must not be on the Financial Action Task Force’s (FATF) list of noncooperative countries. As of September 2015, the AFM had entered into the AIFMD Memorandum of Understanding (MoU) with 44 foreign regulators.⁷²

Funds

152. The AFM follows the same overall process for the registration of new UCITS funds and when notified of new AIFs. All UCITS funds and AIFs sold by authorized AIFMDs are subject to prospectus requirements, although the requirements are less extensive for AIFs offered to professional investors. As described above for asset-backed securities, all prospectuses are reviewed, but more attention is focused on specific information elements within the disclosure documents, and less effort is applied to less critical elements. The AFM uses a structured approach, using both internal and external sources of information, to perform a risk assessment of the transaction and identify the KPRs. These KPRs can be general, issuer or transaction specific, and steer the review. For example, for AIFs the information on the depositary and on the manager is a particular focus. The purpose of the review is to verify compliance with the relevant regulatory requirements. When the AFM is not satisfied with the information provided or the disclosures made, it challenges the proposal or aspects

⁷² Source: ESMA list of AIFMD MoUs signed by the EU authorities.

of it. This usually results in amendments to the fund documentation or withdrawal of the application. Where the AFM receives notification of a new AIF from an AIFM that was automatically licensed when the AIFMD was implemented, the AFM reviews the application particularly carefully and the prospectus is assessed in detail. This has led to the rejection of several applications because the prospectus did not comply with the law. The AFM also uses the review of the prospectus as an opportunity to ensure the AIFM complies more widely with the relevant AIFMD requirements.

Foreign funds and managers

153. The requirements set out in the UCITS and AIFM Directives on cross-border offering or management of funds applies with few, if any, additional requirements imposed by the Netherlands authorities.

A description of the rules that apply to cross-border offering and management of funds is set out in Appendix II. These largely track the requirements in the directives without any additional requirements imposed at the national level. The one material exception is for licensed fund managers established in a member state other than the Netherlands who wish to offer their EU AIFs to Dutch retail investors. The fund manager will have to meet the specific requirements applicable in the Netherlands for offering units to nonprofessional investors (the “top-up retail regime”) which necessitates more extensive disclosure to bring the AIF prospectus into alignment with the information provided in a UCITS prospectus. To use this regime, European fund managers need to complete the passport procedure, send a retail distribution notice form to the AFM, and provide a signed declaration wherein the fund manager explicitly states that it will meet the top up requirements in the Netherlands when it offers units in an AIF to nonprofessional investors.

D. Supervision

Organization and resources

154. IOSCO principles require the regulator to apply proper supervision throughout the life of a particular CIS and CIS operator that promotes high standards of competence, integrity and investor protection.⁷³ The regulator should have clear responsibilities and powers with respect to inspections, investigations and authority to take remedial action in the event of breach or default. The ongoing review should involve both off-site monitoring, such as review of regulatory reports and appropriate performance of on-site inspections of entities involved in operating CIS (CIS operators, custodians, etc.).

155. The AFM devotes significant resources to the supervision of funds and fund managers. Responsibility for supervision of funds and managers is divided between two divisions: Asset Management and Retail Investors. The various activities the AFM performs regarding the authorization of applications as well as the ongoing supervision of the different type of CIS, their fund managers, depositaries and the investment companies (licensed under MiFID), are now brought together in a newly formed Asset Management Division. This division also is responsible for supervising the distribution of funds to institutional investors. The division has 26 FTEs (including

⁷³ Principle 24, Key Questions 6–9.

support staff) with 12 FTEs dedicated to licensing and 9 to supervision and enforcement in 2016. The ongoing supervision of distribution and investment services to retail investors is carried out in a separate Retail Investor Division, which also focuses on suitability risks and is responsible for the monitoring and enforcement of transparency requirements with respect to offerings to these investors. Both divisions work closely together in order to optimize results.

156. The department at the DNB primarily responsible for supervision of fund managers is the Supervision Investment Firms and CIS. The department consists of 12 staff: 9 supervisors and 3 analysts. Its activities are supported by various other departments within the DNB such as Supervision Policy, Statistics, Intervention, Financial Stability, and On-Site Supervision, whose expertise can be called upon when needed.

Powers

157. The supervisors have extensive powers for the performance of examinations and investigations at the fund manager, CIS and the depository. As discussed under the Auditor section, Dutch administrative law does not formally distinguish between inspections and investigations. The same legal basis for carrying out inspections and investigations applies and the supervisors have the same broad supervisory powers for each activity.

Supervisory approach

158. The AFM's supervision is risk-oriented. The risk analysis is based on signals from consumers, investors and other stakeholders, the insights the AFM acquires during interviews and investigations, and information collected from regular and ad hoc reports. Output from the risk analysis influences the prioritization of both thematic inspections as well as both inspections or investigations of individual companies, depending on the type of risk (e.g., is it an issue at the individual fund or manager level or market wide?) or the nature of the signal.

159. Fund managers with a large potential impact (because of their size or role) on the market are under more intensive supervision by the AFM. In addition to supervisory activities performed by the Asset Management Division, a dedicated account management team within the AFM monitors the conduct of these significant entities and may design and execute specific supervisory strategies if deemed necessary. To fulfill this task they may request additional reports such as compliance and audit reports or send questionnaires on specific topics. Large UCITS fund managers⁷⁴ and other fund managers under increased supervision are visited at least once a year by the supervision teams of the AFM. On-Site examinations are not full-scope but focus on specific areas such as the outsourcing policies, risk management and separation of functions, investment policy and

⁷⁴ Four UCITS managers fall into this category. The threshold in practice for a UCITS manager to be considered large is €1 billion in AUM.

liquidity, and NAV calculations. Smaller fund managers are supervised by another supervision team. For these fund managers, risk indicators are used, such as: general signals, Total Expense Ratio, Portfolio Turnover Rate, other signals of “churning,” and auditors’ reports.

160. The AFM monitors the activities of the UCITS fund managers and the depositaries on an ongoing basis. The AFM conducts “nursery visits” within a year after granting the license. On these visits the AFM assesses the operation of the administrative organization and internal controls (Operational and Control Procedures and Processes) in practice. The ongoing supervision is performed using the overall risk-based model. The supervision program emphasizes compliance with the duty of care.

161. The day-to-day supervision of AIFMs by the AFM has been focused on ensuring that all fund managers comply with the requirements of the AIFMD. As previously described, ensuring all AIFMs meet the AIFMD requirements has required a great deal of effort by the AFM. As this process is very resource intensive, regular on-site inspections and thematic inspections under the AIFMD regime have not yet taken place but are planned to start in the near future.⁷⁵

162. The AFM also engages in thematic reviews in areas indicated by the risk analysis process. The AFM’s risk analysis and prioritization processes lead to the formation of themes. Within these themes, project teams may look into different risks. The thematic investigations⁷⁶ the AFM has performed during the last three years are:

- Risks of securities lending across the majority of the UCITS fund managers;
- “Index-huggers.” In 2015, the AFM performed an investigation into UCITS funds that qualify as index-huggers, or closet index tracking funds. Closet indexing or index-hugging refers to the practice of fund managers claiming to manage portfolios actively (and charging higher fees) when in reality the fund stays close to a benchmark (which should be less expensive). The findings were published in 2016;
- Low volatility products. In May 2015, the AFM published a study on low volatility funds. In the report, the AFM makes clear that there are major differences in how volatility is measured, and how effectively the funds are able to reduce the volatility of the fund prices;
- Sustainable investing (both AIFs and UCITS funds) In response to the growing interest in environmental, social and corporate governance (sustainable) investments, the AFM has conducted interviews with a number of fund managers and assessed their investment policies and

⁷⁵ Some on-site inspections have taken place on a case-by-case basis, such as in relation to a reorganization or an authorization.

⁷⁶ As noted above, these are not “for cause” enforcement-type examinations. Many of these bear more resemblance to studies than thematic inspections or routine supervisory inspections seen in other jurisdictions.

processes to get an idea of how they apply sustainable investment criteria in their funds. The AFM has found that there are many differences between fund houses in the way they interpret the criteria. The AFM follows the developments in the market with interest; and

- Real estate funds. In 2013, the AFM investigated to what extent fund managers of real estate funds have financially controlled and sound business operations. The investigation focused on potential financial risks,⁷⁷ contamination risks⁷⁸ and security risks. The AFM investigated to what extent fund managers were able to adjust the cost level in order to cope with decreasing income from management fees; what actions the fund manager took to secure financing for the funds; the level of information (correct, transparent and fair presentation) to the fund participants; and to what extent there is active rental management by the administrator.

163. The DNB's supervision activities are also risk-based. The supervisor has categorized the fund managers (both AIF and UCITS) according to their T-score (in line with the DNB's general FOCUS! methodology that categorizes all institutions under the DNB supervision according to their risk-profile). The fund managers are placed in category T1, T2 or T3 (with T5 being the highest risk category). The initial categorization is determined by the size of AUM, the type of client and the reputation of the firm.

- For the different T-categories a supervisory plan is set and updated on a yearly basis. The smaller and less risky institutions (T1 and T2) are subject to the regular prudential off-site monitoring. If events occur, appropriate action is taken on a case-by-case basis including on-site examinations and formal measures. The action plans are designed by the supervisors in cooperation with the DNB's intervention and enforcement department. When formal measures are taken the intervention and enforcement department determines what is appropriate.
- In addition to the above mentioned activities, the T3 institutions are subject to account supervision, which includes off-site prudential monitoring, regular institution visits, and interviews conducted with the board, risk, compliance and other relevant parties to ensure that the DNB has sufficient information on the risks, mitigating policies and daily functioning of the different institutions.
- As for T4 and T5 firms, all three T categories of firms are expected to prepare a yearly Internal Capital Adequacy Assessment Program (ICAAP) assessment. All T3 institutions must file this yearly and one or two T1 and T2 institutions are selected to file on an ad hoc basis. The ICAAPs prepared by the institutions are reviewed by the DNB supervisors, benchmarked against each other and discussed/challenged by panels (composed of the DNB management, supervisors of other sectors (banks, insurance and pension funds) and the AFM). The outcome of this assessment is discussed with the boards of the institutions. Unlike for banks, the DNB does not have the authority under the CRR to impose additional capital requirements based on the

⁷⁷ Financial risks may occur if real estate funds breach loan-to-value ratios, are not able to meet (additional) repayment obligations and face bankruptcy.

⁷⁸ Contamination risk may exist when a fund manager, for example, is (jointly) liable for or guarantees a loan from a bank to a related party.

outcomes of this process. However, informal means are used to encourage increased capital levels. For 2017 onsite visits will also take the form of onsite investigations, both regarding institution-specific issues and more sector wide concerns (IT, outsourcing).

- Every six months, the T3 institutions are scored by the supervisors on a number of selected risks according to the FOCUS! methodology in an automated system called Riskwise. T2 and T1 institutions are scored in groups according to their specifications. These scores are challenged by a panel (panel members include representatives from other departments and management) and approved by management.

164. The DNB regularly carries out thematic investigations called Risk Identification Projects (RIPs) and Risk Mitigation Projects (RMPs). The selection of RIPs and RMPs is also done bi-annually after the risk scoring and is based upon perceived risks, persistent gaps and signals from third parties. These RIPs/RMPs are conducted on an individual level or more sector-wide. The thematic investigations conducted on fund managers have included:

- Investigation regarding the operational risks for a selected population of fund managers;
- The impact of FINTECH on fund management business models;
- Compliance with international best practices pertaining to remuneration policies for fund managers; and
- Assessment of the adequacy of the professional indemnity insurance held by fund managers.

165. Additional thematic investigations are planned. They include on-site inspections regarding the modeling used for the ICAAP; and fund managers exit plans in case of a wind-down scenario.

166. The resources devoted to on-site supervision of CIS and their managers should be increased, particularly routine on-site inspections. Effective supervision requires a combination of both on-site and off-site supervision. Risk-based supervision is an accepted supervision technique, but it may miss developments that are not yet part of the risk analysis process. Business practices may slip at supervised entities if they do not have a reasonable expectation of seeing a regulator on-site. It is also extremely difficult to do effective supervision of business conduct without doing on-site examinations. Finally, IOSCO generally expects on-site supervision to be part of the supervision of CIS. Both supervisors have on-site supervision programs, but the resources devoted to CIS are not extensive, nor are the inspections frequent. The supervisors should be conducting more examinations of firms and consider conducting some comprehensive examinations to get a fuller view of the managers' actual practices.

167. All fund managers are subject to regular off-site prudential monitoring. Twice a year the DNB receives statements on the prudential position of fund managers. The statements have been designed by the DNB based on the financial reporting (FINREP) and common reporting framework

(COREP)⁷⁹ for investment firms. There is an automated process in place that monitors whether the prudential position of the fund manager is in line with its prudential requirements. Every report is subject to a consistency/plausibility check on items that can significantly impact the prudential position of the investment fund, for example the calculation of the fixed overhead and the appropriate use and reporting of a professional indemnity insurance.

Reporting

168. The supervisors have extensive powers to obtain information on a regular or ad hoc basis. As noted above, the AFM and the DNB have extensive statutory powers to request any information from any person that is reasonably necessary for the due fulfillment of their responsibilities and exercise of their powers. The AFM and the DNB may request fund managers to supply them with additional information regarding themselves, the (type of) AIFs or UCITS funds, depositaries and any other relevant entities. If an event has occurred that seriously affects or may seriously affect the financial position of a financial undertaking such as an AIF manager or a UCITS management company, the DNB has the authority to prescribe that one or more statements (e-line reports) must be submitted with a higher frequency or within a shorter period than would normally be required. Neither supervisor has the power to require more frequent reporting on a routine basis, such as to require all funds of a certain type to file quarterly, rather than annually.

169. Both supervisors receive routine and ad hoc reports from fund managers and funds. Each AIFM licensed by the AFM must provide the AFM with annual financial and management statements for the manager and each AIF it offers in the Netherlands and each EEA fund it manages within six months of the year-end of the fund. Additional disclosure requirements apply to funds offered to retail investors. The manager must also file interim reports within nine weeks of the end of the first six months of the fund's fiscal year. These statements must be published on the manager's website. UCITS funds and managers are obliged to file annual financial statements with the AFM and the DNB within four months of the funds' year-end and interim (semi-annual) statements on the same timing as for AIFs. The fund manager is obliged to file prudential statements (as described above in paragraph 164) with the DNB annually or semi-annually, depending on the nature of the manager's business and license, not later than the last working day of the month following the reporting period. A Dutch AIFM also has to file the information specified in the AIFMD on the AIFs it

⁷⁹ Common Reporting (COREP) is the standardized reporting framework issued by the European Banking Authority (EBA) for the Capital Requirements Directive (Directive 2013/36/EU of the European Parliament and of the Council of June 26, 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ 2013, L 176) reporting. It covers credit risk, market risk, operational risk, own funds and capital adequacy ratios. FINREP is the standardized financial reporting framework and includes primary statements (balance sheet and income statement); disclosure of financial assets and liabilities; financial assets disclosure and off-balance sheet activities; comprehensive income and equity financial statements; financial assets disclosures, and off-balance sheet activities and nonfinancial instrument disclosures.

manages regarding risk-management, use of leverage and results of stress testing. Equivalent information from UCITS managers on stress testing or risk management is not required to be filed routinely, but can be requested on a case-by-case basis.

170. In addition, as required under the AIFMD, the DNB receives regular reports on the AIFs under management by Dutch fund managers. These reports are designed by ESMA and the frequency of reporting depends on the size and risk of the funds, with the largest funds or those using leverage reporting quarterly. Under the twin peaks structure, these reports are sent to the DNB. The DNB and the AFM are currently developing the infrastructure to provide the data to the AFM so that it can be forwarded to ESMA as required. At the same time, ESMA is developing the systems necessary to receive and aggregate the information from each member country and analyze it from a regional perspective. The reports include the information required by the AIFMD on main instruments held, principal exposures and most important concentrations of the AIFs. In its analysis of the information, the DNB focuses on leverage within individual funds. However, the reporting template is complicated, not particularly well understood by the managers, and lacks user-friendly guidance on how to complete it, which reduces the accuracy of the reporting and the usefulness of the aggregate information generated. The definitions used in the template are also subject to varying interpretations. As a result, the DNB has two projects (thematic investigations) ongoing related to leverage: (a) to improve the data quality of the leverage information; and (b) to develop a framework to assess the leverage in AIFs. The latter is being done in cooperation with the ECB. The results are expected at the end of 2016.

171. Information about cross-border fund transactions that do not involve a Dutch fund manager or the Netherlands domiciled fund is not easily available to supervisors. Information is collected at the national level and is to be forwarded to ESMA. Particular information necessary for domestic supervision purposes may be requested from other countries' competent authorities on an ad hoc basis, but there is no simple way to access that information routinely. While the AIFMD transparency reporting ostensibly applies to non-EEA managers and funds, the DNB published a notice that non-EU managers were not required to file the reports for 2015.

172. Effective supervision of CIS, their managers and related stability matters requires good data, and getting better data will require efforts on several fronts. To improve the consistency of AIFMD reporting and, thus, the quality of the information produced, the supervisors should:

- Work with ESMA and their fellow supervisors on improving the reporting template and related guidance, particularly with respect to clarification of the definitions of the terms used; and
- Continue to work with the industry, through workshops and additional "how to" guidance, to enhance the industry's understanding of the requirements.

173. Incomplete data will hamper proper analyses of risk. The supervisors should ensure, as far as possible, that data from all managers and funds that are sold in the EEA (whether managed within the EU or from outside) are captured in the information where relevant for systemic risk monitoring. The authorities should also ensure that the full ESMA database (when operational) is available to supervisors so that they can obtain complete relevant information for national supervision activities.

Dutch authorities should also ensure active cooperation takes place with the home country authorities of the non-Dutch managers of Dutch domiciled funds, as the bulk of Dutch UCITS funds are managed from outside the country (see paragraph 91). Finally, to be useful for prudential supervision, the prudential statements from managers need to be timely enough to give early warning of changes of concern.⁸⁰ The authorities should consider whether prudential reporting by fund managers should be more frequent than semi-annual as large changes can happen in six months. Quarterly reporting, as required for investment firms, may be preferable.

Use of supervisory and enforcement tools

174. The supervisors have a wide range of formal enforcement measures at their disposal.

They can, for example,

- Appoint a conservator;
- Give an instruction, such as to suspend the redemption of units;
- Impose an administrative fine;
- Impose an order for interim penalty payments; and
- Withdraw the license.

175. The supervisors also have the power to bar an executive director, a policy maker or a person in charge of the day-to-day policy, if such a person no longer complies with the rules regarding suitability. Further, the DNB may give a direction to a manager obliging it to adopt a certain course of conduct on specific points. A direction may be issued if either institution fails to comply with the provisions of the law or the DNB identifies signs of a development that may endanger the entity's own funds, solvency or liquidity.

176. The supervisors have published a joint enforcement policy that sets out the relevant circumstances in deciding whether a violation has taken place and whether to proceed with enforcement. The policy describes how they supervise compliance with financial laws and regulations, the principles on which their enforcement policy is based, the factors involved in applying available enforcement tools and their accountability. The policy mentions a number of practical factors which affect their decision on whether to impose enforcement measures against a violator, including voluntary disclosure of the violation to the supervisor; the violator's initiative to terminate the violation; its attitude towards the supervisor (cooperative or not); adequate follow-up to measures suggested by the supervisor; and management involvement with the violation.

177. The AFM and the DNB also use informal instruments to change noncompliant behavior of the fund manager, depositary or CIS. These instruments include sending a letter requesting a change of behavior or having a constructive conversation on compliance with standards at which the

⁸⁰ IOSCO Principle 30, Key Issue 2 and Key Question 6. The Principle talks about capital requirements but the same policy considerations would apply to reporting of other information for prudential purposes.

noncompliant behavior and the necessary change are discussed with the company. When a CIS or firm does not put in place the required changes, the AFM and the DNB usually move to use formal measures. Whether the AFM and the DNB choose to start with informal or formal measures depends on the severity of the situation, including the risk for investors, the repercussions for its prudential position and the previous history of the CIS or firm.

178. The AFM has used its enforcement powers in the investment management sector. In 2015, the AFM issued a public warning with respect to two AIFs. That same year, 40 informal enforcement measures were imposed on AIFs. The table below sets out more specific information on the administrative fines, the most serious formal enforcement measure that the AFM imposed, during the period 2014–15.

Table 12. Netherlands: Formal Enforcement Actions of the AFM in the Period 2014–15

| Year | Administrative Fine | Type of Entity | Violation |
|------|---------------------|----------------|--|
| 2015 | €750.000 | Asset Manager | Breach of the obligation to organize its operations so as to safeguard controlled and sound business operations. |
| 2014 | €100.000 | Administrator | Offering rights of participation in a unit trust, not holding the required license. |

Source: AFM.

179. The DNB uses its enforcement powers in the investment management sector. When institutions fail to meet prudential requirements or the information required to be filed is late or flawed, the DNB takes action in accordance with enforcement policies that have been published on its website. There is a formal process for dealing with a firm that has breached its capital requirements. The process sets out the monetary penalties for the first breach in 25 months and for any subsequent breaches. Less formal processes apply to non-monetary sanctions, such as orders for interim penalty payments. When the DNB is of the view that a firm is unable to comply with the prudential requirements on an ongoing basis, it asks the AFM to revoke the firm's license. The matter then becomes one for the AFM to hear and decide.

Table 13. Netherlands: Formal Enforcement Actions of the DNB in the Period 2011–15

| Year | Supervisory measure | Type of Entity | Violation |
|-----------|------------------------------------|--------------------|---|
| 2016 | Order for interim penalty payments | Asset Manager | Failure to comply with the prudential capital requirements. |
| 2014/2015 | No measures | | |
| 2013 | Instruction | Fund Manager | Failure to comply with the prudential capital requirements and controlled operations. |
| 2012 | Instruction | Fund Manager | Failure to comply with the prudential capital requirements. |
| 2012 | Instruction | Fund Manager | Failure to comply with the prudential capital requirements. |
| 2011 | Instruction | Investment Company | Failure to comply with the prudential capital requirements and requirements on controlled operations. |

Source: DNB.

E. Systemic Risk Monitoring

180. Both the AFM and the DNB have statutory responsibilities relating to financial stability.

The DNB has a prudential supervision mandate to support the stability of the Dutch financial system, both at the level of individual institutions and on a system-wide basis. This is carried out through various activities, including explicit monitoring of potential systemic risks and assessments of financial stability. The AFM is required to carry out its conduct supervision mandate recognizing and addressing potential systemic risk and stability issues. The AIFMD also places an express responsibility on supervisors to monitor the systemic risks of AIFs.

181. In analyzing and monitoring systemic risks, the AFM and the DNB are working together closely.

The risk of market disruptions arising from fund and investment management activities, with potential systemic implications, is high on the agenda of the AFM and the DNB. For the coming year both institutions will continue their cooperation in analyzing the systemic risk elements of the investment management industry, and based on this contribute to the international policy discussion around these risks and possible mitigating measures. Joint DNB-AFM analyses on risks in investment funds also have been discussed in the most recent meetings of the Dutch Financial Stability Committee (FSC) (see below). Specific focus will be put on systemic risks that can be attributed to liquidity and leverage. The aim is to further investigate the prospects and limitations of applying existing microprudential tools to mitigate these risks, and thereby contribute to macroprudential objectives. For example, the AFM will explore the possibilities for using license requirements at the

micro level to mitigate systemic risks on a macro level. The DNB is working to operationalize the leverage limits for AIFs and to translate the macro-level risks into its regular microprudential supervision.

182. The DNB and the AFM conduct analyses on investment fund leverage and liquidity.

Leverage is assessed using both macroeconomic statistics and the AIFMD data, as well as and market liquidity with the European Market Infrastructure Regulation⁸¹ (EMIR) and MiFID data provided by the AFM. The information is institution-specific and, thus, confidential, and it is analyzed to identify macro-level risks in the Dutch fund sector and to pinpoint institution-specific risks. The AFM is currently using AIFMD data to analyze investment fund liquidity by comparing the liquidity of the underlying assets and the redemption period stated by the fund. As part of a DNB-wide liquidity and run risk project, the DNB has just begun a RIP on liquidity risks at investment funds using data from its supervisory activities, such as stress test results. The project includes looking at what is being done in practice at the manager level to manage these risks. One early challenge is agreeing on a common set of definitions. Another is that the information available is not very good. It is not clear enough or accurate enough, especially at the aggregate level. The DNB and the AFM therefore are working to improve the data.

183. The supervisors are also active in international groups working on asset management stability issues. Both supervisors participate in working groups dealing with risks related to the asset management industry within the European Systemic Risk Board (ESRB), the Financial Stability Board and/or IOSCO. Especially in the ESRB, there is information sharing of aggregate data on the fund sector in the work on shadow banking, and some institution-specific data (from the largest European jurisdictions) for the analyses of market liquidity. The purpose of information sharing is to identify systemic risks in a timely fashion.

FSC

184. The FSC brings together the MoF, DNB and AFM with the objective of identifying risks to financial stability in the Netherlands and making appropriate recommendations. The FSC was formed following a post-crisis parliamentary enquiry. Senior officials of the MoF and the supervisors are committee members and it is chaired by the president of the DNB. The Netherlands Bureau for Economic Policy Analysis attends meetings as an external expert. The Committee meets at least twice a year to discuss developments concerning financial stability of the Dutch financial system, including the way in which warnings and recommendations of the ESRB should be implemented in the Netherlands. While issues relating to shadow banking generally (and asset management issues in particular) have been discussed, the principal focus of this forum has been issues relating to real estate mortgage financing.

⁸¹ Regulation (EU) No 648/2012 of the European Parliament and of the Council of July 4, 2012 on OTC derivatives, central counterparties and trade repositories.

185. Both supervisors have established groups to address stability issues. The AFM has created a Financial Stability Forum within the supervisor. The forum is currently chaired by the Head of the Asset Management Division and consists of delegates of various AFM divisions who meet every one to two months to discuss macro trends/developments and potential systemic risks. The scope is AFM-wide and not just focused on asset management issues. A small team for financial stability analysis, consisting of members from various divisions assigned part time, carries out the work agenda. If needed, the team conducts analyses concerning specific stability topics, often in close cooperation with one or more specific divisions. The AFM input on topics to be discussed in the FSC are prepared by members of the financial stability team. The DNB has established the Committee on Financial Stability. It is chaired by the Director of the Financial Stability Division and comprised of senior management members. Among other tasks, it prepares the DNB's positions for discussions at the FSC.

186. The new Asset Management Division is exploring the possibilities of using more quantitative analysis in both routine supervision and financial stability activities. This work is in its early stages of development. Within the Division a data team, closely cooperating with other internal and external specialists, has been formed to analyze the potential of the data that is generated by the AIFMD reporting requirements. This project has three aspects:

- Improving the quality of the AIFMD data provided by the fund managers by combining this data with other information available from a variety of sources such as markets, the DNB macroeconomic statistics, data generated by other EU directives (such as the EMIR that can be used to monitor the use of derivatives, and from MiFID on transactions), fund documents, such as disclosure documents, self-assessments and regular financial reports, ongoing supervision information and signals, and other national and international data/risk information;
- Assessing the scope and limits of the available data in order to get a better understanding of its potential use for monitoring and mapping of trends and developments and corresponding (potential) systemic risk implications; and
- Exploring whether the data received under the AIFMD (i.e., data about the funds individually, rather than at the fund manager level) provides valuable input for broader conduct of business supervision of fund managers.

187. The first analysis has recently been delivered on the domestic AIF market. The analysis used information from reporting under the AIFMD and other information available to the supervisor, such as prospectus disclosure.

188. The Asset Management Division and its financial stability team collaborate on stability topics related to the asset management sector. For example, in a joint effort, the Asset Management Division and the financial stability team (together with the DNB) are currently investigating whether there are Dutch real estate funds with liquidity mismatches that may give rise to systemic risk. This project is also looking at the extent into which the “high risk” combination exists

of open-ended real estate funds (with frequent redemption rights) that invest in illiquid assets⁸² and in which investors are likely to make use of these redemption rights (i.e., retail investors or other open-ended funds). The possibility that this high-risk combination might lead to “fire sales” by the manager/fund in order to meet the redemption demands is also being assessed, along with whether enough preventive and/or reactive liquidity management tools can be used by the manager to prevent that from happening. The existing disclosure provided to investors on these tools is part of the review. The project is identifying which additional liquidity management tools might be needed in the areas where the present liquidity management tools of the manager/fund are insufficient. Simultaneously, an assessment is being made of the sufficiency of the supervisors’ authority to require funds or managers to make use of all available liquidity management tools. It is recommended that the assessment of the supervisors’ powers, with respect to the use of liquidity management tools, be pursued in any event, even if the risks of this particular aspect of the funds industry proves to be not material.

⁸² Such as the direct ownership of residential or commercial property.

Appendix I. Full Recommendations on Securities Regulation and Supervision

| Recommendations | Timing ¹ |
|--|---------------------|
| Regulator | |
| Grant the supervisors a high level of autonomy for deciding on exceptions to the salary cap that is proposed to apply to staff of the supervisors. | I |
| Amend the legislation to provide that a board member may only be removed for specified, objective causes. | I |
| Pursue legal reform to expand the rule-making authority of the AFM and the DNB. | I |
| Clarify the conditions under which the MoF power to set aside rules of the supervisors would be exercised and make these transparent to the public. | I |
| Amend the legislation to expand the AFM's authority to obtain information from telecom providers and freeze assets. | NT |
| Amend the legislation to expand the authority of both the DNB and AFM to conduct examinations and investigations using outside experts. | NT |
| Market-based finance | |
| Amend the legislation to broaden the supervisory authority of the AFM with regard to loan-based crowd-funding. | NT |
| Auditor oversight | |
| Enhance transparency by requiring all public issuers and auditors to make prompt public disclosure of auditor/audit firm changes or resignations. | I |
| Devote more resources to routine on-site reviews of PIE-audit firms other than the four largest international firms and to periodic spot-checking at non-PIE-audit firms. | NT |
| Renegotiate the agreements with the accounting professional associations to give the AFM express control over key issues on the reviews of non-PIE firms. | NT |
| Fund management | |
| Work to ensure the significant shareholders of AIFMs are subject to the same supervisory assessments of their suitability and financial soundness as apply to MiFID firms and UCITS fund managers. | MT |
| Keep a close watch on the growth of MMFs and ensure that any new funds authorized comply with the safeguards of the IOSCO policy recommendations for MMFs. | I |
| Enhance liquidity risk management requirements for UCITS fund managers; consider requiring routine reporting of liquidity data and stress testing results by UCITS fund managers. | NT |
| Develop a practical approach to measuring investment fund leverage and continue to contribute to international work to harmonize the leverage calculation method. | MT |
| Assess the risks from the use of related depositaries and consider requiring additional safeguards to address these risks. | NT |

| | |
|--|----|
| Provide guidance to the marketplace on what is expected to be in place when a depositary is a related party of a CIS manager. | I |
| Contribute to the EU level discussions on the development of a common approach to asset segregation requirements for CIS. | NT |
| Both supervisors should conduct more on-site examinations of firms and consider conducting some comprehensive examinations to get a fuller view of actual practices. | NT |
| Work with ESMA and fellow supervisors on improving the AIFMD reporting template and related guidance, particularly with respect to clarification of the definitions of the terms used and continue to work with the industry, through workshops and additional “how to” guidance, to enhance industry’s understanding of the requirements. | NT |
| Consider whether prudential reporting for fund managers should be more frequent than semi-annual as large changes can occur in six months. | NT |
| Ensure that all data needed for supervision and systemic risk monitoring is available on a timely basis and strive for enhanced international exchange of information. | NT |
| Pursue an assessment of the supervisors’ powers with respect to the use of liquidity management tools at CIS. | NT |
| ¹ I (immediate): within one year; NT (near term): one–three years; MT (medium term): three–five years. | |

Appendix II. Cross-Border Offering of Funds and Fund Management Services

With few exceptions, the Dutch rules governing cross-border offering of funds and fund management services are based on the AIFMD and UCITS Directive.

Dutch fund managers with non-EU AIFs. A licensed Dutch AIFM may only offer units in a non-EU AIF in the Netherlands if the state where the AIF is located is not listed on the FATF's list of noncooperative countries and the AFM and the supervisory authority of the state where the non-EU-AIF is established have concluded a cooperation agreement that (at least) ensures an efficient exchange of information and enables the AFM to perform its statutory supervisory functions. The AFM has MoUs with 44 regulators and countries in this regard. Effectively, the AIFM must comply with all requirements in the Directive, i.e., in general the same supervisory functions and requirements are applicable as with EU-funds, including in relation to their depositary.

EU managers with non-EU AIFs. An EU AIFM of a non-EU AIF can use its EU AIFMD license to offer units of a non-EU AIF which it manages to professional investors in the Netherlands using the national private placement regime. Article 36 AIFMD allows member states to impose any additional national requirements on a licensed EU fund manager that intends to offer units of a non-EU AIF to professional investors. The Netherlands does not impose any additional requirements.

This regime is only applicable to third countries where the non-EU AIF is established, provided:

- The relevant third country is not on FATF's list of Noncooperative Countries and Territories;
- Appropriate cooperation arrangements are in place between the competent authorities of the relevant third country and the relevant member state to facilitate efficient information exchange between those competent authorities; and
- The relevant third country must have signed an agreement complying with OECD Model Tax Convention and ensure effective exchange of information in tax matters.

In order to be able to effectively make use of the cooperation agreement, the AFM requires an attestation by the home regulator of the non-EU AIF that the fund falls under the supervisory scope of the competent authority of that third country.

EU fund manager offering units of an EU-AIF.

- Offered to Professional Investors: EU fund managers may offer units of an EU-AIF in the Netherlands to professional investors using the passport regime.
- Offered to Retail Investors: Licensed fund managers established in a member state other than the Netherlands may offer EU AIFs to Dutch retail investors. The fund manager will have to meet the specific requirements applicable in the Netherlands for offering units to nonprofessional investors (the "top-up retail regime"). To use this regime EU fund managers need to complete the passport

procedure, send a retail distribution notice form to the AFM; and provide a signed declaration wherein the fund manager explicitly states that it will meet the top up requirements in the Netherlands when it offers units in an AIF to nonprofessional investors.

Non-EU Fund managers. An AIFM with its registered office in a non-EU state (whether this is a designated state or a non-designated state) may offer units of an AIF in the Netherlands or manage a Dutch AIF if: the units of the AIF may only be offered to professional investors; the manager is not located in a noncooperative jurisdiction; the AFM has a cooperation agreement with the supervisor of the non-EU country where the manager (or if applicable, the AIF) is established; and the fund manager (and, where applicable, the AIF) has provided a confirmation from their relevant supervisory authority that they are a “covered entity” under the cooperation agreement.

Adequate Supervision Funds: Current Dutch supervisory law allows participations in an investment fund that is established in a country designated by the MoF as having adequate supervision to be distributed in the Netherlands to both retail and professional investors without the manager having to be licensed in the Netherlands. The three designated jurisdictions are the United States (but only funds registered with the U.S. Securities and Exchange Commission), Guernsey, and Jersey. The funds are usually listed at Euronext Amsterdam. The ASF must complete a notification process and are subject to requirements with respect to the contents of their prospectus, reporting to investors, advertising and the preparation of annual accounts. Otherwise, the AFM relies on the supervision of these funds by their home supervisor.

In the Netherlands, the ministerial Regulation “on the performance of duties and cross-border cooperation by financial regulators” is in force. This regulation states that the DNB and the AFM, in carrying out their duties under the Wft, need to confirm the provisions of the AIFMD regarding cooperation and information sharing, information on risks (control systems, leverage, systemic risk); compliance by fund managers, including ones located in and outside the EEA; and on-site inspection.

On May 30, 2015, ESMA issued a press release where it approved cooperation arrangements between EU securities regulators and 34 of their global counterparties with responsibility for the supervision of AIFs (including hedge funds, private equity and real estate funds). ESMA has negotiated the agreements on behalf of all securities regulators in the 27 EU member states, as well as the authorities from Iceland, Liechtenstein and Norway. These cooperation arrangements are key elements in allowing EU securities regulators to supervise the way non-EU AIF managers comply with the rules of the AIFMD. These arrangements form a pre-condition in allowing non-EU fund manager access to EU markets or to perform fund management activities on behalf of EU fund managers. These arrangements will apply to non-EU fund managers that manage or market AIFs in the EU and to EU fund managers that manage or market AIFs in third countries. The arrangements also cover cooperation in the cross-border supervision of depositaries and fund managers’ delegates.

UCITS

UCITS funds domiciled and/or managed in the EEA can be sold to Dutch investors (retail or professional) using the passport system contemplated by the UCITS Directive. No separate licensing or authorization of the fund or manager in the Netherlands is required.