

Kingdom of The Netherlands—Netherlands: Financial System Stability Assessment

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

Kingdom of the Netherlands—Netherlands

Financial System Stability Assessment

Prepared by the Monetary and Capital Markets and European Departments

Approved by José Viñals and Antonio Borges

May 23, 2011

This report presents the conclusions of the IMF Financial Sector Assessment Program (FSAP) update mission, which visited the Netherlands in November/December 2010. The FSAP findings and recommendations were discussed with the authorities during the Article IV Consultation mission in March 2011.

The FSAP team comprised Charles Enoch (mission chief), Michael Moore, Ana Carvajal, Thordur Olafsson, Nada Oulidi, Rodolfo Wehrhahn, Mary Wilson, and Jianping Zhou (all MCM); Wouter Bossu (LEG); Daniel Kanda (EUR); Su Hoong Chang (insurance supervision expert); Paul Kupiec (stress test expert); Guillaume Leroy (insurance/actuarial expert); and Michael Taylor (banking expert). The mission received excellent cooperation and support from the authorities. The main findings of the FSAP are:

- The “twin peaks” model has been effective and there is a high degree of compliance with the three regulatory standards—for banking, securities, and insurance.
- Financial institutions have improved their soundness, but nearer term challenges to the system are: (i) the high indebtedness of home buyers; and (ii) external factors.
 - The average loan-to-value ratio is high, well above 100 percent, and macro-prudential instruments should be developed to lower the system’s vulnerability to shocks in this area.
 - The key external risk stems from the sizable cross-border activities of Dutch financial institutions, which require closer scrutiny (including data to enhance monitoring) and supervisory engagement.
- Legislative reforms will be needed to strengthen crisis management and bank resolution capacity, including changes to the deposit guarantee scheme (e.g., ex ante funding, depositor preference in bank resolution).

The main authors of this report are Charles Enoch, Michael Moore, and Jianping Zhou, with contributions from the rest of the FSAP update team.

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

Associated technical notes were also prepared that review (i) the Twin Peaks model; (ii) crisis management framework; and (iii) the pension sector.

Separately from the FSAP, the Netherlands participated in an IMF assessment of the Netherlands’s compliance with the FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism. The detailed assessment report is available at <http://www.imf.org/external/pubs/cat/longres.aspx?sk=24801.0>.

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GLOSSARY

AFM	The Authority for Financial Markets
AFS	Act on Financial Supervision (<i>Wet op het Financieel Toezicht</i>)
AIRB	Advanced Internal Rating Based Approach
AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AOW	Social Insurance Scheme for basic pensions
Awb	General Act on Administrative Rules (<i>Algemene Ouderschaps wet bestuursrecht</i>)
BCP	Basel Core Principles
Bmfo	Decree on Market Access of Financial Institutions (<i>Besluit markttoegang financiële ondernemingen Wft</i>)
Bpr	Decree on Prudential Rules pursuant to the Financial Supervision Act (<i>Besluit prudentiële regels Wft</i>)
Bptfg	Decree on Prudential Supervision of Financial Groups (<i>Besluit prudentieel toezicht financiële groepen Wft</i>)
BW	Civil Code (<i>Burgerlijk Wetboek</i>)
CAR	Capital Adequacy Ratio
CEBS	Committee of European Bank Supervisors
CESR	Committee of European Securities Regulators
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CIS	Collective Investment Schemes
DNB	Netherlands Central Bank - <i>De Nederlandsche Bank</i>
EC	European Commission
EEA	European Economic Area
EL	Expected Loss
ELA	Emergency Liquidity Assistance
ESMA	European Securities Markets Authority
EU	European Union
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principles
IFRS	International Financial Reporting Standards
LCFI	Large Complex Financial Institutions
LGDs	Loss-given defaults
MoF	Ministry of Finance
MoU	Memorandum of Understanding
NPL	Non-performing loans
PDs	Probabilities of default
ROE	Return on Equity
RWA	Risk Weighted Assets
VVGB	Declaration of no objection (<i>Verklaring Van Geen Bezwaar</i>)
WEO	IMF World Economic Outlook forecast
WFD	Financial Intermediaries Act (<i>Wet financiële dienstverlening</i>)

EXECUTIVE SUMMARY

The Netherlands has been heavily affected by the global financial crisis. Public expenditure to provide capital support to banks and insurance companies was significant. Few large financial institutions survived without substantial state support, and state ownership or participation is now extensive. Four of the five largest financial groups are therefore subject to restructuring programs, at the behest of the authorities and the European Commission (EC).

The “twin peaks” supervision model, with DNB as the prudential supervisor, and the AFM responsible for conduct-of-business supervision, was severely tested, although the case for the model remains strong. With the full transition to “twin peaks” completed only in 2007, there are still areas for improvement, including as regards cross-border supervision. However, additional strengths have become evident: with micro and macro prudential oversight concentrated in one institution, DNB has the ability to take a systemic view, which allowed it to react quickly and decisively to address the crisis.

The financial sector remains dominated by systemically important institutions that operate in diverse domestic and international markets. The crisis has shown that these institutions bring sizeable risks, which requires careful and comprehensive monitoring and supervision. This in turn requires strong supervisory institutions, with well-recognized powers, and the willingness and ability to use them.

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

- There is a high degree of compliance with the three regulatory standards assessed—banking, securities, and insurance. For each standard, Netherlands complies, or largely complies, with all principles, except for one principle on securities market regulation.
- Financial soundness has improved compared to 2008. All large banks maintain capitalization buffers well above minimum requirements, which reflects substantial capital support to several large banks during the crisis. The capital augmentation and general return to profitability appear to position the banks well to meet higher Basel III requirements.

DNB is making intensive, and well-focused, efforts to redress earlier shortcomings. Reforms are guided by two publications that indicate a commendable commitment to meeting the challenges of a more intrusive supervisory approach, and to a more proactive and decisive role in supervising the financial sector and enforcing prudential requirements.

- The most challenging vulnerabilities are: (i) the high indebtedness of home buyers and (ii) external risks related to banks’ cross-border activities.

- Households remain heavily indebted, with levels amongst the highest in the EU. Most lending relates to housing, encouraged by generous mortgage interest deductibility (MID). The average loan-to-value (LTV) ratio, well above 100 percent, has continued to rise in recent years. Recent proposals to set a maximum LTV and require 50 percent paydown of principal during the lifetime of the mortgage move in the right direction, but do not go far enough.
- External risks stem from the significant foreign activities of Dutch financial institutions and the local activities of foreign-owned financial institutions, including those from elsewhere in the European Economic Area (EEA). This puts a premium on multilateral and bilateral engagement and coordination, robust monitoring through offsite surveillance, and stress testing that takes account of the external risk dimensions.
- Insurance companies are suffering from a saturated market compounded by low economic growth and low interest rates. With the loss of tax advantage, they are confronting growing competition from banks and asset managers. Life insurers have a serious problem of image, and need to restore public confidence by making a clear break in business plans and in perceptions.
- Facing low interest rates and extended life expectancy, pension funds too are under financial stress. Indexation of benefits has been widely suspended, and maintenance of commitments in nominal terms is under threat. Under existing regulations, the funds are able to adjust their payouts to preserve their own financial positions; but with coverage ratios for many funds below the regulatory minima, supervisory recovery plans have been imposed. DNB's proactive approach, and the wide public debate fostered by the high level of transparency, are welcome.
- Important data gaps are apparent, as the crisis has revealed worldwide a lack of sufficient granularity in data for monitoring financial sector developments. In the Netherlands this is evidenced for instance by the lack of regular and consistent sectoral breakdowns of data on banks' non-performing assets.
- Rulemaking authority is too limited and should be enhanced. Presently, the DNB and the AFM do not have sufficient discretion to put in place enforceable rules that apply at a system-wide level.
- Important progress has been achieved in developing techniques for crisis management and bank resolution, but further reforms are still needed.

Table 1. The Netherlands: Main FSAP Update Recommendations

Recommendations	Priority
<i>Macroprudential Management</i>	
Assign priority to developing macro-prudential instruments. (¶11)	(High)
Announce maximum loan-to-value (LTV) ratios for new lending, and consider linking higher LTVs to higher capital ratios. (¶11)	(High)
Provide supervisors with powers to vary the level of designated macroprudential instruments in response to developments. (¶11)	(Medium)
Announce plans to reduce mortgage interest deductibility over the medium-term. (¶11)	(High)
<i>Twin Peaks</i>	
Provide the DNB and AFM greater discretion to put in place enforceable rules. The lack of sufficient rule making authority leads to ad hoc approaches that risk becoming arbitrary and subject to legal challenge. (¶25 to 28)	(High)
Afford legal protection to DNB and the AFM as institutions, for their official actions, except in cases of gross negligence or willful misconduct, in line with practice in many neighboring countries. (¶28)	(High)
Continue integration of DNB staff across banking, insurance, and pensions functions, so as to draw the synergies of having a single regulator. (¶38)	(Medium)
<i>Microprudential Bank and Insurance Supervision</i>	
Establish routine reporting requirements to strengthen monitoring and risk modeling. (¶31 to 33)	(High)
Intensify supervision of large international financial institutions, with greater emphasis on group supervision and soundness of business models. Greater international cooperation, beyond participation in colleges of supervisors, is warranted. (¶34 to 36)	(High)
Adopt more proactive and decisive approach, including timely off-site inspection and corrective actions that rely less on moral suasion. (¶39)	(High)
<i>Securities market</i>	
Strengthen the AFM's ability to enforce issuers' compliance with financial reporting standards (¶41)	(High)
Strengthen the regulatory and supervisory framework for management companies of collective investment schemes (CIS). (¶45)	(Medium)
<i>Pensions</i>	
Develop a communication plan on recent and prospective changes in payouts to stakeholders. (¶51 to 54)	(High)
Require incorporation of professional Board members for pension funds beyond a minimum size, and provide legal authority that allows direct supervision of core pension activities independently of the entity performing them. (¶48)	(Medium)
<i>Crisis management and bank resolution</i>	
Reform the Deposit Guarantee Scheme so that it is: (i) ex ante funded, (ii) authorized to fund bank resolution operations, and (iii) enjoys depositor preference. (¶49)	(High)
Strengthen the institutional framework for crisis management by: (i) shifting decision-making power from the Judiciary to DNB in the context of bank resolution, and (ii) specifying more clearly the respective roles of the MoF and DNB in bank resolution. (¶51)	(Medium)
Improve the framework for official financial support by establishing a standing budgetary authorization for the Government to fund solvency support in a manner that avoids risk of moral hazard. (¶52)	(Medium)
Improve the framework for bank resolution by establishing a single regime for resolving banks under official control; such regime should set appropriate objectives (including financial stability), as well as tasks and powers for the official administrators. (¶51 to 54)	(High)

I. SOURCES OF POTENTIAL RISK

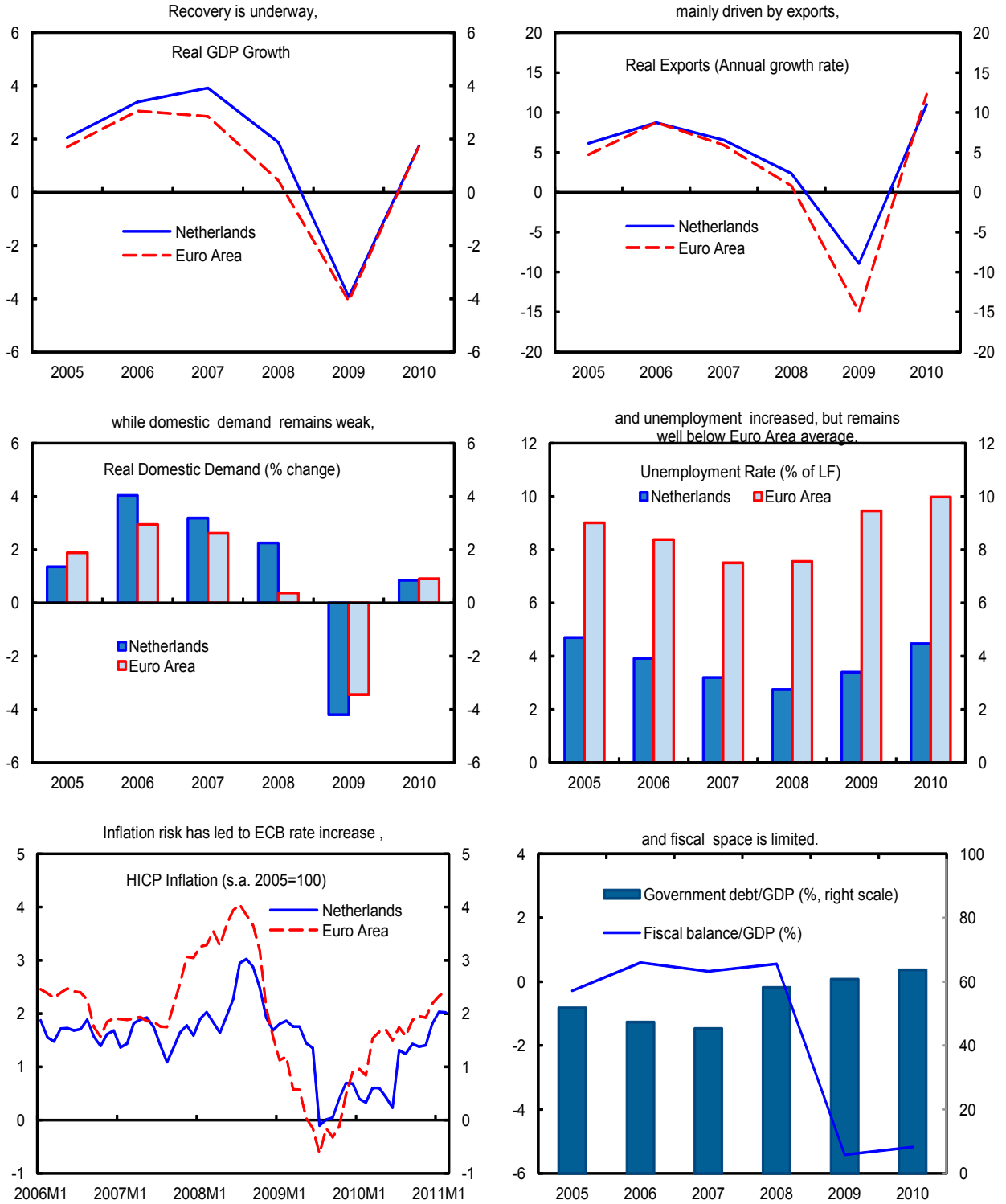
A. Macroeconomic Developments

1. **The Netherlands emerged from a deep recession in mid-2009, in line with the Euro Area, but the recovery remains fragile.** (Figure 1). Output fell sharply in 2009 owing to collapsing exports and falling domestic demand. The subsequent upturn has been driven by a strong pick-up of exports and restocking, but domestic demand remains weak.
2. **Despite the large output contraction, the unemployment rate increased only marginally in 2009 and peaked in 2010 at 4.5 percent.** The unemployment rate is well below the Euro Area average (about 10 percent), mitigating the impact of the crisis on private consumption. Labor hoarding could be one contributing factor, while government-subsidized temporary reduced-hours schemes may also have played a role.
3. **Returning growth to its pre-crisis level remains a policy challenge.** The low interest rate environment could soon end as deflationary risk has faded and inflation has begun to rise sharply, as in much of Europe. With a fiscal deficit standing at more than 5 percent in 2010—compared to small surpluses before 2009—and a public-debt-to-GDP ratio that increased by 18 percentage points between 2007 and 2010, the fiscal space for stimulating domestic demand seems limited.

B. The Financial System and the Crisis

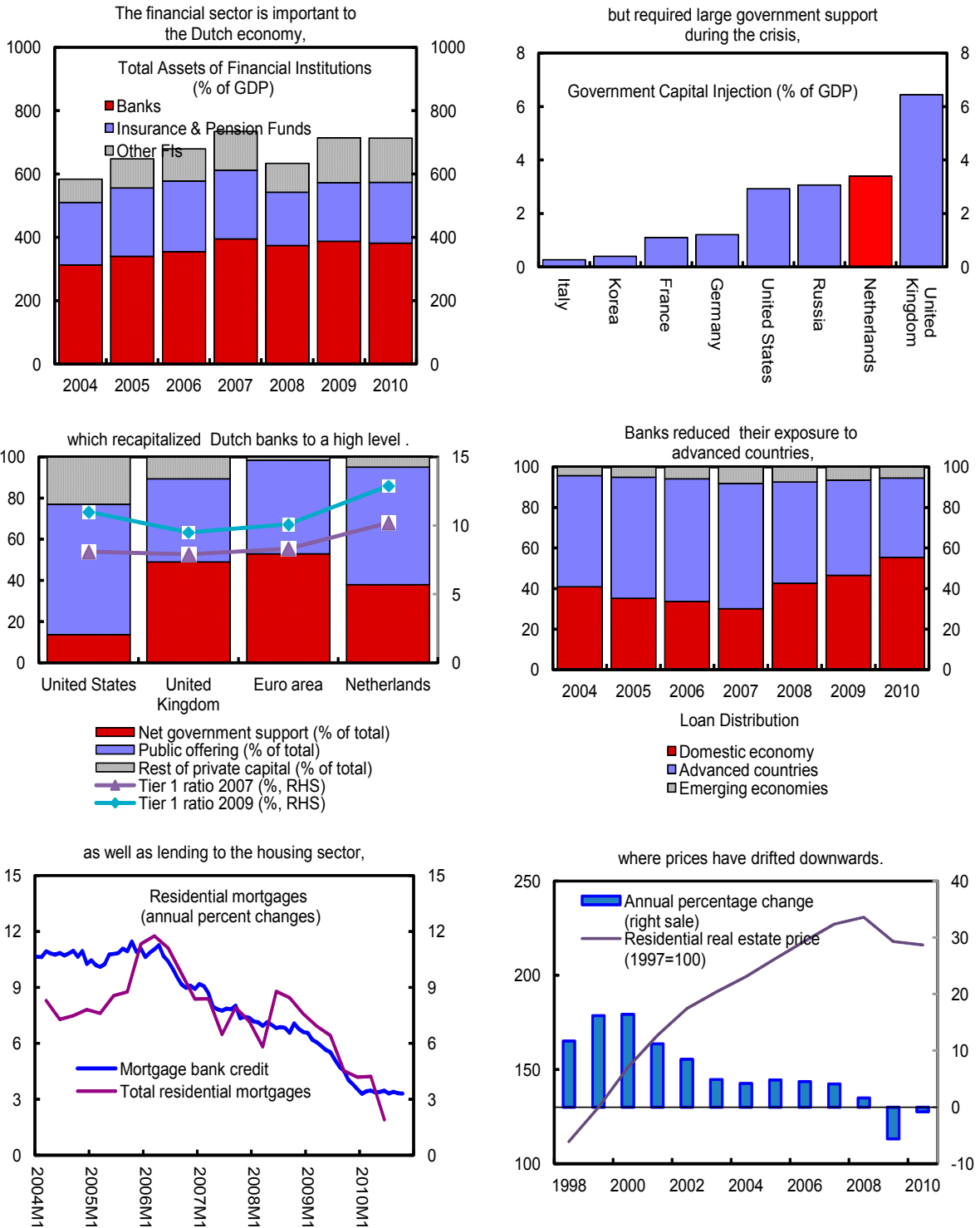
4. **The financial system comprises three main sectors—banking, pensions, and insurance.** Banks, with assets equal to 382 percent of end 2010 GDP, form the core of the financial system. Assets in the pension system are the second most important sector, with assets under management equal to 135 percent of GDP. Though the sector has 545 registered pension schemes, the two largest and ten largest funds manage 44 and 78 percent of scheme assets, respectively. The insurance sector holds assets of 69 percent of GDP, with life insurance assets representing 89 percent of the sector.
5. **Loan exposures are equally distributed between domestic and international markets (mostly advanced countries), although there has been a shift towards the domestic market** (Figure 2). Sovereign exposures account for about 13 percent of the on and off balance sheet exposures. At end 2010, banking liabilities were comprised of deposits (43 percent), external liabilities (23 percent), and issued debt securities (20 percent), which is mostly long and medium-term. At end 2010, the five largest cross border exposures as a percentage of aggregate cross-border exposures are to Belgium (6.2 percent), France (11.3 percent), Germany (9.5 percent), United Kingdom (19.7 percent), and United States (8.3 percent). Exposures of consequence to other countries include Ireland (4.6 percent), Italy (2.7 percent) and Spain (4.1 percent).
6. **The financial system was hit hard by the global financial crisis.** Dutch banks were exposed to U.S. securitized mortgages, including through their U.S. subsidiaries, and were

Figure 1. Macroeconomic Developments and Challenges



Source: WEO.

Figure 2. Financial System and Impact of The Crisis



Sources: DNB, G20 Surveys, WEO, and IMF staff estimates.

affected by the tightening of the inter-bank funding market. The problems of the financial institutions reflected the global reach of Dutch banks into markets with pervasive problems, such as the U.S. subprime and Alt-A mortgage markets. The pension funds and insurance firms too were affected, and required remedial action (including through corrective orders) and, in the case of insurance firms, equity support.

7. **The authorities provided large amounts of public support to strengthen balance sheets along with the adoption of policy measures.** Support actions included a combination of equity injections, liquidity support, and guarantees. Key among the measures was the injections of voting and non-voting equity (qualifying as Tier 1) used to fully recapitalize banks (and one major insurance company). The recapitalization has subsequently allowed the financial institutions to regain access to money market funding. At the policy level, the reaction of the authorities included requiring that (i) financial institutions reduce leverage and build buffers; (ii) supervision become more “intrusive and conclusive”—implemented through the DNB’s VITA initiative; (iii) corporate governance be built up; and (iv) crisis management be strengthened. For the last, the authorities seek an internationally coordinated approach to crisis management, and view it as essential that the European Union play an important role in shaping the international approach.¹

C. Household and Corporate Financial Positions

8. **Household financial net worth has been broadly stable at almost 200 percent of GDP, reflecting the large holdings by the occupational pensions sector.** The value of the housing stock—not included in the financial balance sheet—provides an additional strength. On the liability side, loans have remained broadly stable. Real disposable household income declined during the crisis, as unemployment rose and wage growth declined, and is likely to be anemic over the near medium term. Looking forward, plans for strong fiscal consolidation are likely to squeeze household disposable incomes by raising the tax burden and cutting public spending.

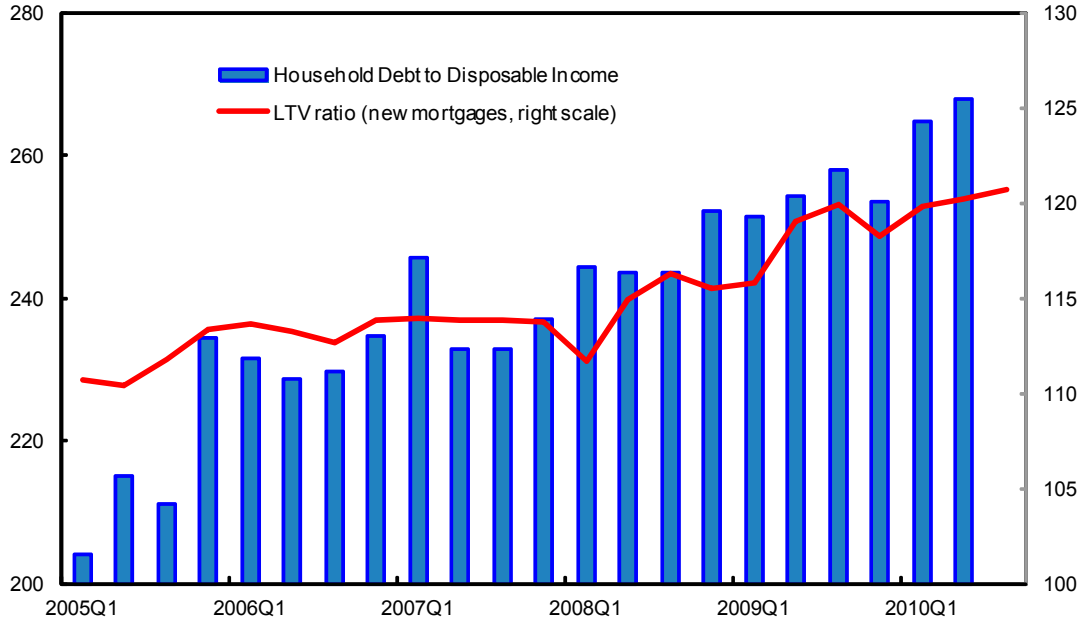
9. **Household liabilities are overwhelmingly long-term, limiting exposure to liquidity risk (Figure 3).** Many of these relate to borrowing for housing. Excluding assets such as pension fund and life insurance assets, which are not marketable without significant penalty, the net financial asset position would have been negative since 2007 Q4.

10. **Further declines in housing prices cannot be ruled out.** House prices rose by 6 percent (annualized) on average during 2000-08, but fell by about 5 percent in 2009. In 2010, house prices stabilized, but house sales declined sharply. More recently, the

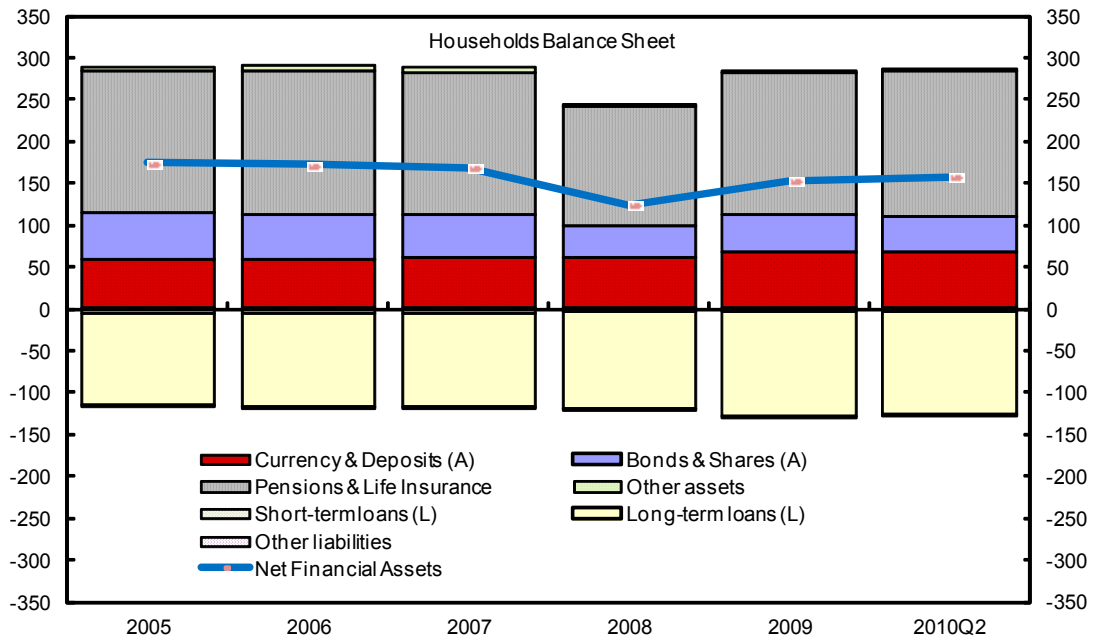
¹ A presentation on the authorities’ view of the crisis can be found at <http://www.dnb.nl/en/news-and-publication/news-and-achive/speeches-2009/dnb.224706.jsp>

Figure 3. Vulnerabilities and Risks in Household Sector

Dutch households indebtedness has increased after the crisis,



and meanwhile household liquidity risk appears little changed.



Sources: DNB, WEO, and Staff estimates.

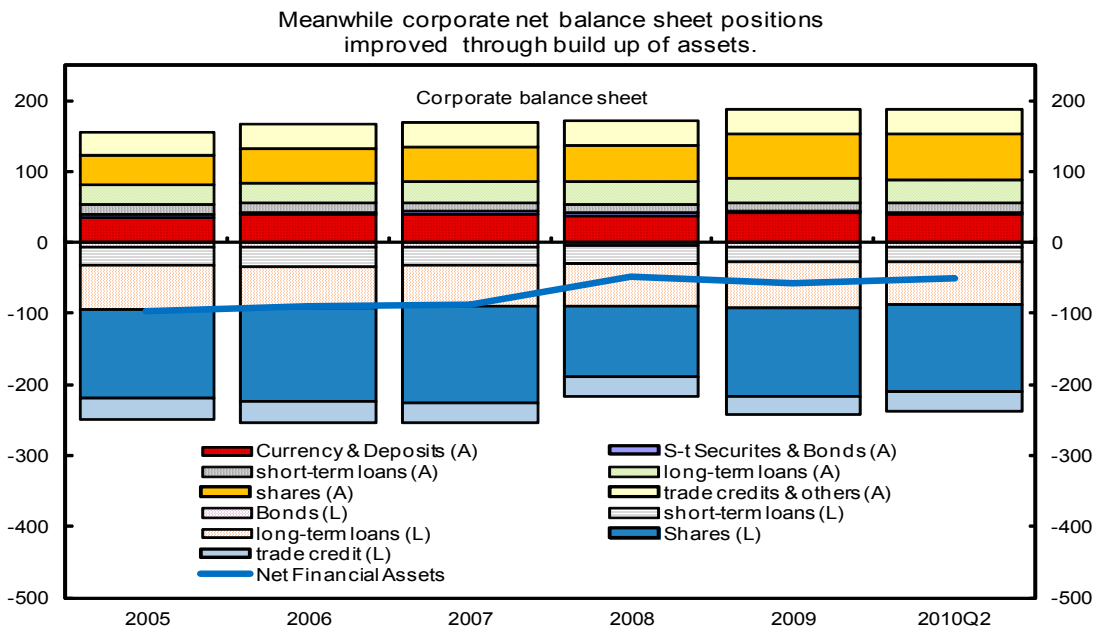
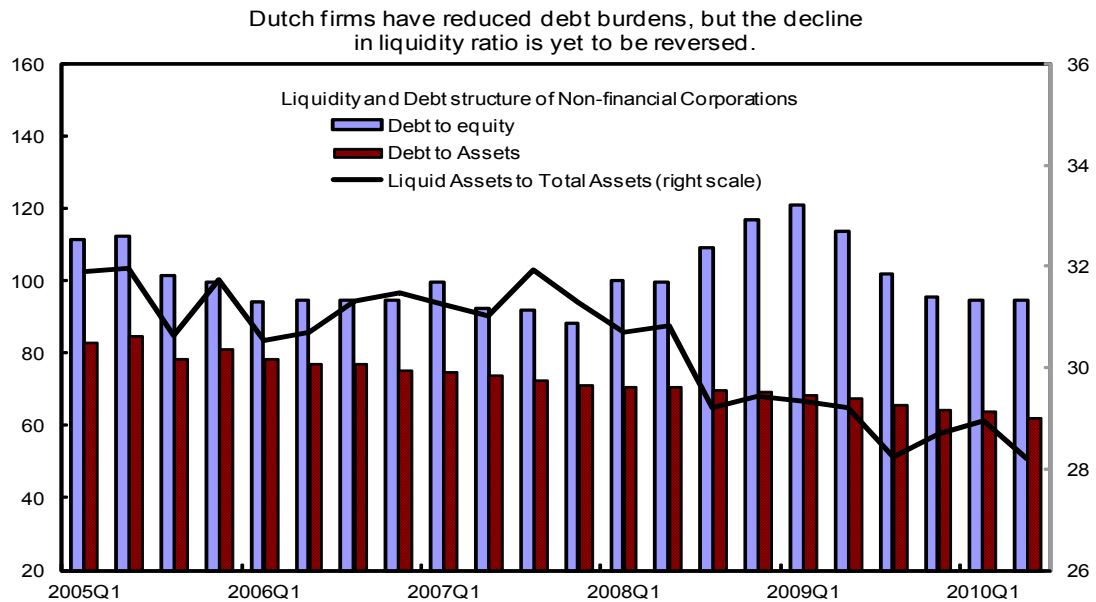
downward trend in house prices has resumed. While IMF staff analysis suggests that an imminent house price collapse is unlikely, indicators of affordability such as the ratios of house prices to rents or disposable income point to potential downward price adjustments.

11. High and rising debt-to-income and mortgage loan-to-value (LTV) ratios suggest that household balance sheets are increasingly stretched. Addressing these through macroprudential policies should be a priority.

- The generous MID regime is a significant driver for the rising household indebtedness. It allows for virtually unlimited deductions for interest payments on mortgages for primary residences. The household debt-to-disposable income ratio has risen to 267 percent in 2010 Q1, among the highest in advanced economies. This signals rising vulnerabilities to income, interest rate, and house price shocks, although relatively high levels of assets (housing, investments) are held against these debts.
- This regime has generated upward pressures on house prices and mortgage size. It has stimulated the growth of mortgages that are interest-only and non-amortizing, with principal accumulated in a separate account (which could be a tax-advantaged savings or investment account or life insurance policy), and amortization at the end of the term of the loan. The rising share of mortgages with highly delayed amortization has helped push the debt-income ratio upward. A further risk is that the amounts invested in life insurance products to amortize mortgages when they fall due are often calculated on the basis of high interest rate projections that have not materialized.
- The resilience in house prices and persistently low unemployment appear to have made banks comfortable with offering loans with high LTV ratios. The average LTV ratio for new mortgages has risen from slightly above 100 percent in 2000 to over 120 percent in 2010, well above prudential norms in most countries, and raising banks' vulnerability. This led to recently announced plans for a reduction in the maximum LTV ratio to 110 percent, coupled with repayment of at least 50 percent of principal over the lifetime of the loan. Additional action is however urgently needed and, beyond setting a maximum LTV limit, consideration could be given to assigning more stringent capital requirements to loans with higher LTVs. Assigning additional powers to DNB and the AFM could facilitate timely action.
- Increasing recourse to mortgage insurance under the National Mortgage Guarantee (NHG) scheme—which now covers mortgage loans worth 110 billion euro out of a total mortgage portfolio of about 600 billion euro—helps reduce bank exposure to losses arising from adverse events in the mortgage market, but also increases the contingent liabilities of government, the NHG's guarantor. Transparency regarding these contingent liabilities could enhance support for changes in this area.

12. **Financial positions of non-financial corporations have improved since the crisis (Figure 4).** The sector was hit hard, with output and profits falling sharply in 2008–09, reversing the rising trends during 1980–2007, resulted in a steadily increase in bankruptcies. However, as recovery takes hold, these trends have reserved. Dutch firms have reduced debt burdens and improved their balance sheet positions by building up assets, although the decline in their liquidity ratios is yet to be reversed.

Figure 4. Improvements in Corporate Sector



Sources: DNB, WEO, and Staff estimates.

II. OVERALL STABILITY ASSESSMENT

A. Financial Stability and Risk Factors

13. **The financial position of financial institutions has been restored, and now seems likely to be robust to a range of shocks.** Table 2 identifies the key risks facing the system, but vulnerabilities are mitigated by recent recapitalizations, including issuance of new capital. The authorities have also taken a number of welcome steps to enhance their financial supervisory practices. Future financial stability will require the maintenance of strong, and indeed enhanced, supervisory standards, as well as close monitoring of unfolding circumstances by financial institutions and their supervisors, and their willingness and ability to react quickly as circumstances require.

B. Stress Testing Vulnerabilities in the Financial System

Banks

14. **Financial soundness has improved** (see Tables 3a and 3b), **but vulnerabilities remain.** The banking sector is highly concentrated, with the assets of the largest seven banks accounting for more than 80 percent of the sector total. The capital adequacy ratio (CAR) of the banking sector stood at 13.9 percent at end-2010, comprised mostly of core Tier 1 capital. The NPL ratio remains at manageable levels (less than 3 percent of total loans) for the banking sector. Profits appear to be recovering in 2010, with a return on equity (ROE) of 7 percent for the sector through 2010. Liquid assets more than cover short-term liabilities. Nevertheless, funding risk remains a challenge, given the reliance on wholesale market funding.

15. **Top-down stress tests were conducted for the seven largest banks (with available data) under three macroeconomic scenarios** (see Table 4). The July 2010 CEBS stress test was the basis for guiding the calibrations of the yield curves shocks; haircut values concerning the Greece, Italy, Ireland, Portugal, and Spain yield shocks were updated from those at the time of the CEBS test to reflect developments in the debt markets following official intervention in Ireland's banks, and applied also to the banking book. The three scenarios examined comprise: (i) a baseline scenario based on IMF World Economic Outlook (WEO) projections for GDP growth, unemployment, and interest rates; (ii) a double-dip scenario (Figure 5) using July 2010 CEBS deviations from baselines for the 2011–12 stress projections for GDP growth, unemployment, and interest rates (iii) a more severe double-dip scenario (Figure 6) that used twice the deviations from baseline for the macroeconomic and the EU sovereign bond market shocks.

16. **Under all three scenarios the banks showed resiliency.** Under scenario 1, all banks experienced declines from 2010 reported Tier 1 capital ratios, but no bank fell below the 4 percent regulatory minimum, or the 6 percent CEBS Tier 1 target. Even under adverse scenario 2, estimates suggest that all banks would remain above the current regulatory minimum of

4 percent Tier 1 capital and the CEBS 6 percent Tier 1 target.

Figure 5. Adverse Scenario 1: Bank Tier 1 Capital Ratios Measured as a Percentage of the Average Baseline Ratio

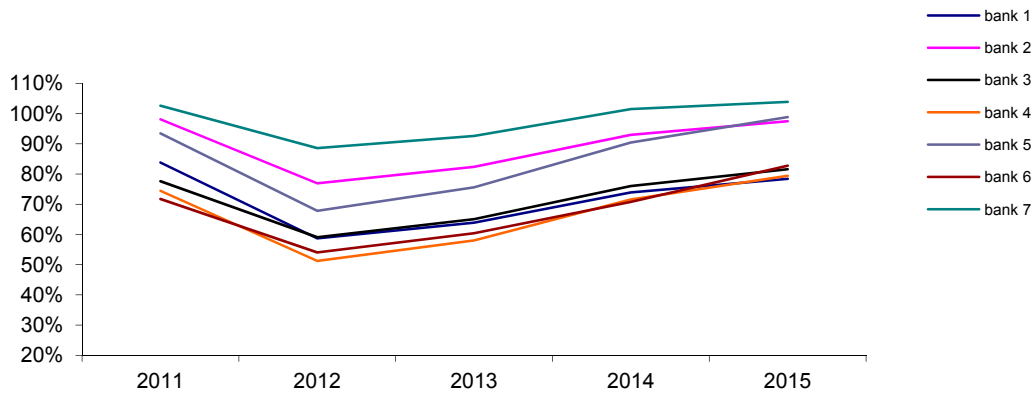
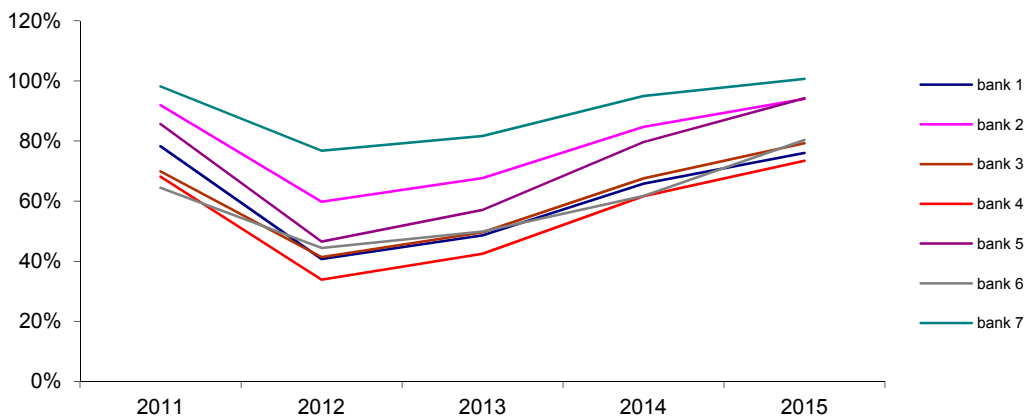
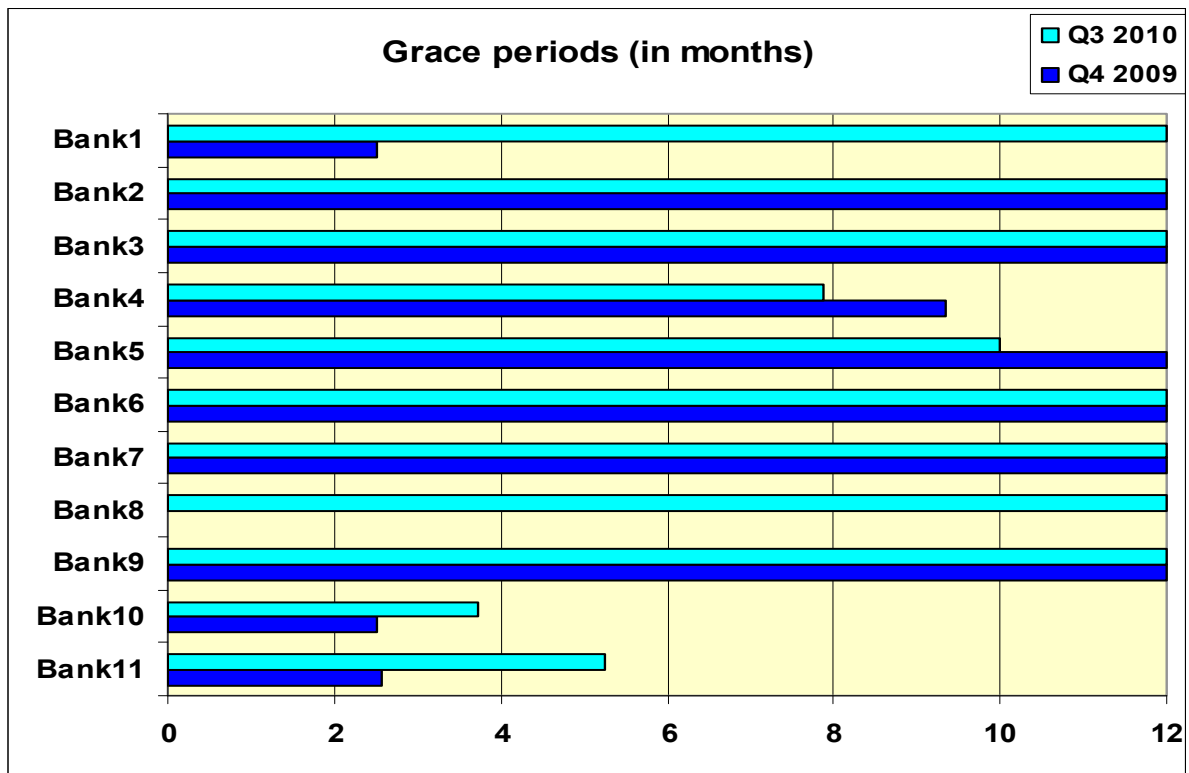


Figure 6. Adverse Scenario 2: Bank Tier 1 Capital Ratios Measured as a Percentage of the Average Baseline Ratio



17. **DNB’s supervision process routinely tests the liquidity risks of individual banks.**² DNB stress-testing methodology is based on modified maturity gap approach. Liabilities are assumed to “run,” and assets are assumed to be liquidated at stress discounts from mark-to-market values in order to meet liquidity demands. The results from two scenarios were shared with the mission, showing the number of months that banks could survive liquidity stress conditions as of 2009 Q4 and 2010 Q3. Details for 11 banks are illustrated in Figure 7, which show that liquidity has improved between these two periods. DNB has used its liquidity stress test results as a basis for encouraging banks to improve their liquidity risk management practices.

Figure 7. The Netherlands: Number of Months Banks Hold Liquidity Buffers



Source: DNB staff estimates.

Insurance companies

18. **In recent years, the life insurance companies have significantly reduced their exposure to equity and real estate markets, but remains vulnerable to interest rate risk.** The life insurance companies have limited buffers in terms of discretionary benefits, due to

² The FSAP mission did not directly validate the liquidity stress test results because of data limitations. DNB ran the liquidity tests for more banks than were covered in the mission’s solvency tests.

competition for guaranteed rates and profit sharing schemes, which make them more sensitive to financial risks.

19. Stress tests on the insurance companies reveal wide disparity in their prospects.

While some suffer under the medium-term low growth/low interest rate scenarios, others are much less affected, or even strengthen their position over the projection period. This disparate performance and the strong competition environment suggests the likelihood of industry consolidation in the future, but adaptations in the firms' business models reflecting the new environment are already evident.

Pension funds

20. The pension system is second only to the banking sector in size and potential systemic importance.

There are 545 pension funds, with the ten largest funds holding 78 percent of total pension scheme assets. The pillar 2 pension schemes, which supplement the national scheme, have assets under management larger than the Netherlands' GDP.

21. The occupational pension sector is under strain from the prolonged low interest rate environment and an increase in life expectancy.

The cover ratios of the assets of the funds to their pension commitments fell from 130 percent to around 100 percent at end 2010, which is below the 105 percent regulatory requirement. For underfunded schemes, this triggered unprecedented measures from the supervisor, which has included the suspension of indexation of accrued benefits. In addition, 340 pension funds are under supervisory recovery plans, with the prospect that some funds may need to cut benefits in order to boost the cover ratio back to the minimum regulatory level.

22. As a response to the pension fund crisis, negotiations are under way on risk sharing and risk transference.

Discussions are being held between the social partners to find a consensual route to handle the situation. The issue of long-term sustainability has been brought to the fore at a relatively early stage because of the high level of transparency in accounting and disclosure practices. For the future, care should be taken to ensure proper understanding by all parties of the risks assumed in pension contracts.

III. FINANCIAL AND SYSTEMIC OVERSIGHT

A. Regulatory Architecture—Cross-Sectoral Issues

23. The assessment shows a high degree of compliance with the three key regulatory standards. In all three standards Netherlands complies, or largely complies, with all the core principles, apart from one principle of the IOSCO securities market standard.

24. Notwithstanding these results, there is no room for complacency. As a result of the global financial crisis, many accepted practices and standards are being revised and enhanced,

both in international fora³ and specifically in the Netherlands. DNB is undertaking its own consultation process to reform regulatory and supervisory arrangements.⁴ ⁵In order to further strengthen the supervisory framework, a number of themes cut across the regulated sectors. These are set out below.

Rule-making authority

25. The ability of DNB and the AFM to apply prudential or conduct-of-business rules at a system-wide level is constrained. The effect is twofold:

- The agencies are placed in a position where, rather than introduce system-wide prudential or conduct-of-business norms in a particular circumstance, they must approach the regulated institutions individually citing *ad hoc* factors. This risks that approaches may become arbitrary and subject to waiver.
- The *ad hoc* nature of the rule-making also risks chilling supervisors' willingness to act forcefully, including, out of concern that the request will be challenged.

26. A specific area of concern is the explicit legal restriction against imposing broadly applicable intra-group exposure limits to insurance groups; instead these are controlled case-by-case through indirect measures. Also, DNB's powers to mandate prudential reporting were limited by requirements of the Ministry of Economic Affairs to reduce regulatory burden. This latter example indicates more broadly also a potential obstacle to the adoption of macro-prudential instruments to address the build-up of system-wide vulnerabilities.

27. The regulatory agencies should have discretion to put in place enforceable rules that apply broadly over supervised institutions. For example, in the manner of a central bank having discretion to set interest rates, DNB should have the ability to vary macro-prudential instruments within a given range in line with emerging economic or financial conditions. The AFM should have clear legal authority to exercise oversight over product development.

28. For effective implementation of the enhanced supervisory regime, the supervisory authorities need to be adequately resourced and empowered. There is scope for broadening the legal authority of DNB and the AFM not just to set rules within the current legal parameters established by the MoF but at a sufficient level to facilitate timely and effective supervision and

³ See FSB November 2010 paper *Intensity and Effectiveness of SIFI Supervision—Recommendations for enhanced supervision*—http://www.financialstabilityboard.org/publications/r_101101.pdf.

⁴ See DNB publications: *DNB Supervisory Strategy 2010–2014 and Themes 2010* and *From Analysis to Action (August 2010)*.

⁵ In addition, since January 2011 macro-prudential issues fall under the auspices of the newly-established European Systemic Risk Board, and three European Securities Authorities have oversight over micro-prudential issues. The work of these agencies is covered in more detail in the report of the IMF's European Financial Stability Framework Exercise (EFFE) currently under preparation.

intervention. In line with international best practice, consideration should be given to providing explicit legal protection to DNB and the AFM against lawsuits for actions taken in good faith while discharging their duties, provided they have not demonstrated willful negligence.

Limits on legal authority at the holding company level

29. **DNB's legal authority over financial holding companies is constrained in two regards:**

- For mixed financial conglomerates (for instance, a group that operates both in insurance and banking), legal authority for DNB to act against the holding company is limited to ensuring that the holding company has in place adequate risk management and internal control procedures, with power to give instructions when deemed necessary.
- For insurance groups, DNB has the limited authority noted above; it has no other enforcement power against a non-regulated holding company, and its use of indirect measures to influence intra-group exposures potentially could be subject to legal challenge.

30. **With respect to the mixed conglomerates, this issue has been identified as a weakness in many European financial systems, and work is underway to issue a new EU directive.** The Commission is also working to amend the financial conglomerates directive. For insurance groups, DNB has developed mechanisms (for instance, placing conditions on the license of the regulated entity) to work around its inability to supervise group activities directly. This has satisfied some supervisory requirements, but more should be done to ensure that DNB has direct authority over groups.

Adequacy of information for coordinated risk assessment

31. **DNB's efforts to employ a more intensive approach to supervision are welcome; however the intensity of supervision will need to be complemented with better offsite monitoring.** Key will be the availability of regulatory reporting information that is sufficient to monitor the material risks at regulated entities and financial groups. Presently, monitoring is predominantly through management information systems used by individual financial institutions, rather than by a regular on-sight presence of regulators. .

32. **Regulatory reporting is not sufficient to form a comprehensive view of an individual institution.** Reporting suffers from a lack of timeliness, and quarterly returns are not formalized. Consistent and sufficiently comprehensive information should be strengthened. An expanded set of routinely collected regulatory reporting information is needed to (i) better inform offsite monitoring, including for purposes of stress tests, and to increase capacity for early warning of

impending difficulties; (ii) reduce the need for *ad hoc* requests; and (iii) facilitate the sharing of relevant financial information with foreign supervisors.

33. **A subset of the regulatory reporting should be provided as a public release of financial information on individual institutions** (preferably on a quarterly basis). DNB already provides institution-specific information on insurance firms via its website; however, bank data are only provided in aggregate form. A regime of providing regulatory reporting to market participants could be introduced over a cycle and as credit markets begin to stabilize. Such a reporting requirement would exclude information that is supervisory in nature. For example, customer/client and large exposures information would remain confidential

International linkages and coordination

34. **Supervisory colleges are an important innovation to reinforce home-host coordination for supervisors of Large Complex Financial Institutions (LCFIs)**. A number of supervisory college meetings have already taken place in the Netherlands, and the infrastructure for regularizing such arrangements is taking shape. However, the multilateral exchanges of information that are characteristic of supervisory colleges are not a substitute for a home authority to have detailed knowledge of the operations abroad of the institutions that it supervises, and it is not clear what are the incentives for full disclosure of difficulties in a particular jurisdiction. Anecdotal evidence from initial meetings suggests that, at this stage at least, some participants seem wary of a full and frank exchange of information.

35. **The recent economic crisis demonstrated the risk of contagion from problems in foreign jurisdictions and over-reliance on host supervision**. DNB therefore needs to complement its work through the supervisory colleges with heightened direct understanding of the activities of Dutch financial institutions abroad, and the environments in which they work. This will likely require devoting additional resources to supervision.

36. **The advent of the single financial market in Europe brings clear benefits, but also additional supervisory challenges**. In the context of securities markets, the AFM has been proactive in participating in the college of supervisors for Euronext N.V., and engaging with other EU supervisors through the Committee of European Securities Regulators (CESR). However, such arrangements cannot overcome the inherent limitation of a regulatory and supervisory framework that rests on the fragmented authority of domestic supervisors. Thus, in the long run, the supervisory authorities in the region might wish to centralize more functions to avoid the risk of regulatory arbitrage and fragmented views of risks. The assignment of full supervisory responsibilities over credit rating agencies to the European Securities Markets Authority (ESMA) constitutes a good starting point for further centralization.

B. Regulatory Architecture—Key Financial Sector Standards

Banking supervision

37. **Many of the recommendations from the Basel Core Principles (BCP) assessment in the 2003/2004 FSAP have been implemented.** This is reflected in the high level of compliance in the present assessment. Reforms were undertaken with the adoption of the “twin peaks” regulatory structure, underpinned by the Act on Financial Supervision (AFS). Nonetheless, the new supervisory system remains a work in progress and some of the potential benefits of a “twin peaks” structure have yet to be fully realized.

38. **The allocation of resources to banking supervision does not appear to be fully commensurate with the nature and scale of the risks that the banking system poses to the Netherlands.** The scale of the activities of the foreign subsidiaries of Dutch banks was such that they could, and subsequently did, become a threat to the viability of their groups as a whole. Notwithstanding the established division of responsibilities between home and host authorities in respect of supervision of cross-border subsidiaries, the extent of their activities would justify a greater commitment of DNB’s resources to enable a more intrusive approach to their monitoring.

39. **Full implementation of a “twin peaks” structure should allow the authorities to make more flexible decisions on the commitment of supervisory resources to systemically important sectors and firms.** The “twin peaks” model of supervision was introduced in 2002, although the institutional transition was completed only in 2007 (Box 1). Despite the creation of a single prudential regulator, it appears that banking, insurance, and pension supervision remain largely compartmentalized. Although supervisory staff will never be entirely fungible between sectors, a single management structure should provide a mechanism for resources to be allocated between them on the basis of their systemic significance. This assessment would likely result in a rebalancing of resources towards banks; the rebalancing could take place over time, through recruitment and the re-training of existing staff.

40. **The second respect in which the advantages of a “twin peaks” structure are only now being fully realized relates to the practice of banking supervision.** The merger of the banking supervision function with pensions and insurance is only now resulting in a significant change to the way that the former was practiced. DNB’s approach to banking supervision reflected the approach of many central banks, i.e., emphasis was placed on “moral suasion.” Now DNB has introduced welcome measures to change the culture, and has adopted the comprehensive “VITA” project to make supervision more “intrusive and conclusive.”

Box 1. The Netherlands: “Twin Peaks” Model of Supervision

In 2002 the authorities adopted an objective-based “twin peaks” supervisory model. Under this model, DNB became a single prudential supervisor for all financial institutions (banks, insurance companies, investment firms, pension funds, and securities firms), and the Authority for Financial Markets (AFM) was created as supervisor responsible for conduct-of-business supervision including supervision of security market activities, with a strong focus on market behavior and consumer/investor protection.

The design of the “twin peaks” model was based on several considerations:

- The preference for a unified prudential supervisor was driven by changes in the financial industry structure, which had become dominated by a few very large financial conglomerates operating across bank/insurance/pension lines, and offering increasingly complex financial products that blurred the conventional credit/insurance/securities boundaries.
- The preference for objective-based supervision led to the separation of prudential and conduct-of-business supervision under different agencies, or “twin peaks.” The preference was based on the view that the objective of prudential supervision is to safeguard financial stability, while the objective of conduct-of-business supervision is to protect consumers. Despite synergies between them, they require different skill sets and different tools to achieve their individual objective. That said, problems in conduct-of-business are often precursors of prudential difficulties, so focus on appropriate conduct-of-business practices should assist financial stability.
- The decision to locate the unified prudential supervisor within DNB was based on (i) synergies between prudential and monetary policy aspects and close link between macroeconomic stability and financial stability; (ii) the expectation that prudential supervisors could benefit from the central bank’s macroeconomic analysis, as well as from the central bank’s long standing credibility; and (iii) the intention to enhance DNB’s role with new responsibilities at the time when monetary policies became the responsibility of the European Central bank (ECB)—this would limit the potential conflict of interest between monetary policy and financial stability objectives.

With the full transition to “twin peaks” completed only in 2007, there are still areas for improvement, including as regards cross-border supervision. However, additional strengths have become evident: with micro and macro prudential oversight concentrated in one institution, DNB has the ability to take a systemic view, which allowed it to react quickly and decisively to address the crisis.

Securities markets regulation

41. **As the primary supervisor of the securities market, the AFM has developed a supervisory framework that exhibits high levels of implementation of the IOSCO Principles.** For its supervision of intermediaries (banks, investment firms, management companies of collective investment schemes), the AFM uses a risk-based approach, developing themes that become the focus of on-site supervision, complemented with an institution-based program of both off and on-site supervision for high impact firms. Its supervision of markets also follows a risk-based approach, and thus significant resources are dedicated to the supervision of Euronext Amsterdam, as well as to Euronext N.V. Supervisory programs are implemented under a clear enforcement strategy. The AFM is perceived as a credible and effective enforcer.

42. **The AFM's efforts are complemented by DNB's program of prudential supervision, which for investment firms is appropriate and credible.** DNB's program for the supervision of investment firms is based on the activities that they undertake. As a result, most supervisory resources are spent on the investment firms that conduct riskier activities. Such firms are subject to on-site inspections on an annual cycle, while remaining firms are visited every three years. DNB has recently strengthened its approach towards compliance with reporting obligations. Consequently, compliance has improved.

43. **Gaps in the legal framework for issuers, in the case of the AFM, and that for the management of collective investment schemes, in the case of DNB, have imposed limitations on the supervision of these activities.** The AFM has limited authority to request information from issuers to ensure compliance with financial reporting standards. In the case of management companies, the legal framework does not subject some types of management companies to solvency requirements, nor to the review of qualified holdings, and the reporting obligations established by the law for all management companies are not sufficient from a prudential perspective. Whether due to those limitations, or because of limited resources, DNB does not conduct on-site inspections of management companies, except if there is a signal of concern.

44. **Mechanisms to enforce issuers' compliance with financial reporting standards should be strengthened** by: (i) providing the AFM with the legal authority to request information from issuers to assess the accuracy of the financial statements; (ii) extending to at least nine months the period given to the AFM to file an action before the Enterprise Chamber of the Amsterdam Court; and (iii) eliminating the fire walls that prevent the sharing of information between the AFM's departments.

45. **The regulatory and supervisory framework for management companies of Collective Investment Schemes (CIS) should be strengthened** by: (i) subjecting all management companies to solvency requirements and reviews of qualified holdings; (ii) providing DNB with legal authority to establish reporting obligations for prudential purposes; and (iii) enhancing prudential supervision, by striking a better balance between off site supervision and on-site inspection. Finally, the ability of DNB and the AFM to act swiftly in

situations where a regulatory response to an emerging risk is needed should be strengthened by expanding their rulemaking authority, under a framework of accountability to the MoF.

Insurance sector supervision

46. **Since the 2003/2004 FSAP, the Netherlands has undertaken significant reforms, particularly in its legislative framework and risk-based supervision.** The AFS provides a consolidated legal framework for supervising the financial sector. Together with related regulations, it establishes clear regulatory requirements for licensing, corporate governance, internal controls, group-wide supervision, technical provisions, supervision of intermediaries, as well as consumer protection. It thereby facilitates the implementation of the “twin peaks” regulatory structure and provides clarity to the authorities’ supervisory mandates. The legal framework is supported by DNB’s risk-based methodology, and the recent introduction of macro-prudential supervision and proactive market analysis. Significant progress has thus been made in addressing most of the recommendations from the earlier FSAP.

47. **The updated regulatory regime has a high level of observance with the Insurance Core Principles (ICPs), and the authorities are responsive to global market and regulatory developments.** DNB’s Supervisory Strategy for 2010–2014 incorporates the key lessons learnt from the global financial crisis. DNB will implement tighter supervision by adopting a supra-institutional approach in macro-prudential supervision, to complement the traditional micro-prudential supervision. It will devote more attention to institutions’ business models and strategies, as well as their culture and conduct. The implementation of Solvency II in 2013 will sharpen risk-based supervision and strengthen the oversight of insurance groups and financial conglomerates

Pension funds

48. **Pension funds are organised as a foundation (*Stichting*) and are legally separate from their respective companies.** There is no general statutory obligation for employers to make pension commitments to employees but, once a commitment is made, the Pension Act (*Pensioenwet*), with effect from January 1, 2007, safeguards the rights of participants and beneficiaries. The Pension Act created a clear statutory framework, introducing a risk-sensitive supervisory framework for pension funds. The AFM is charged with conduct of business supervision and DNB with prudential supervision. For the future, it would be helpful to develop a communication plan and require the incorporation of professional Board Members for pension funds of a given size and complexity, and to provide legal authority that allows direct supervision of core pension activities independently of the entity performing them.

C. Deposit Insurance

49. **The temporary increase in deposit insurance was an essential element for stabilizing the situation during the crisis.** Preparations are under way for establishing a permanent scheme. In case of bank insolvency, the present deposit guarantee scheme (DGS), which is

managed by DNB, pays out insured deposits over a period of several months. DNB funds the pay-out, which subsequently recovers the cost from the banks. The DGS is not authorized to fund deposit transfers, or “purchase and assumption” transactions.

50. **A number of improvements could be made.** The DGS should be redesigned away from a “pay-box system” into an effective tool for resolving insolvent banks. The broad elements of DGS design are being determined at the EU level, but the Netherlands could take action as regards the national scheme in a number of areas⁶:

- ***Ex Ante Funding***—The DGS should be funded ex ante by contributions paid by banks (possibly calculated on a risk-based formula), and the contributions invested in liquid instruments so as to be readily available for pay-out. If funds are insufficient for payouts, the authorities should be authorized to close the funding gap.
- ***Contribution to Resolution***—The DGS should be allowed to support certain bank restructuring transactions rather than only pay out depositors. Specifically, it should be authorized to perform its insurance obligations by transferring insured deposits to another bank, either through the auction of the relevant component of the deposit book or through “purchase and assumption” transactions whereby insured deposits and a corresponding amount of assets are transferred from the insolvent bank to a transferee bank. In case of insufficient assets, the DGS would compensate the transferee for acquiring the liabilities.
- ***Timeliness***—Plans are in train to cut the present lag before payouts to around 20 days. Efforts should be made to be able to ensure a more rapid payout (or transfer of deposits).
- ***Depositor Preference***—Insured depositors and the DGS should be given priority rights over the estate of the failed bank. Such priority protects the contributing banks and ultimately the public purse, and simplifies “purchase and assumption” transactions.

D. Resolution Arrangements

51. **The institutional set-up of the official crisis response is clear and broadly appropriate.** The respective responsibilities of the MoF, DNB, the AFM, and the Judiciary are well understood. The main areas that warrant attention are:

- Shifting decision-making from the Judiciary to DNB in the context of bank resolution, to ensure adequate attention to financial stability, and improve speed, and

⁶ All these changes would be consistent with keeping the DGS within DNB.

consistency with related actions (such as DNB’s provision of Emergency Liquidity Assistance (ELA)); and

- Calibrating the respective roles of the MoF and DNB in bank resolution during a systemic crisis, given the potential cost to the public.

52. **With one caveat, the overall framework for official financial support to stem systemic crises is adequate.** The framework for the provision of emergency liquidity assistance by DNB is robust and flexible, but it might be useful to provide clarification on the parameters that guide DNB in providing such assistance. As regards solvency support, a weakness is the absence in the budget laws of a standing budgetary authorization for the Government to fund such support to avoid that official commitments for solvency support become unfunded. This could be remedied by an amendment to the Public Accounts Law or other relevant legislation. If well designed (e.g., ensuring private creditors would take appropriate losses), the implications for moral hazard would be limited, or even positive.

53. **The current framework for resolving ailing banks in going concern needs to be strengthened.** The special manager “*stille curator*” has unclear objectives, does not fully replace management, and lacks explicit resolution powers. Moreover, the “emergency mechanism” is designed to protect creditors (with no place for financial stability concerns), court driven, and leads to almost a total moratorium, thus pushing banks towards a gone concern. These weaknesses could be remedied by providing DNB a single regime for resolving banks under official control—such a regime should set objectives (including financial stability), tasks and powers for the official administrators—although the instruments for resolving the bank under private control should be strengthened too (see Box 2).

54. **The framework for orderly liquidation of banks should also be strengthened and fine-tuned.** Introducing a consultative, if not steering, role for DNB and the AFM throughout the resolution process would be helpful in ensuring that financial stability concerns are robustly addressed. The introduction of mechanisms that support the rapid transfer of deposits and assets, as well as essential functions, would also be critical. Any reform of this framework should be closely coordinated with corresponding enhancements of the DGS as discussed above.

Box 2. Strengthening the Framework for Resolving Banks as Going Concerns

The actions set out below would enhance the framework for resolving banks. However, none is a panacea in isolation, and their overall effectiveness will depend on how they are used in combination with other tools, such as official financial support (including ELA and guarantees) and a reformed DGS scheme.

- Strengthen DNB’s hands in utilizing directions and cease-and-desist orders as an effective **early intervention tool**.
- Make DNB’s powers to **change directors and management** of banks more explicit.
- Grant DNB power to appoint, instruct and dismiss **official administrators** on the basis of qualitative and quantitative triggers. The main objective of official administration should be to contribute to the overall soundness of the banking system by providing orderly resolution; the pursuit of creditor interests ought to come second.
- Ensure that the **basic tasks of the official administrator** should be to (i) assess the real financial situation of the bank, (ii) where necessary, establish a new balance sheet reflecting a fair and true view of that financial situation, (iii) write down capital and convert subordinated debt into capital as needed; (iv) where possible, design and implement a restructuring plan for the bank (after DNB approval), and (v) in case restructuring is not an option, prepare the bank for orderly liquidation.
- Grant the official administrator strong and explicit **restructuring powers**. This requires, first and foremost, that the administrator fully takes over the powers of all decision-making bodies of the ailing bank, the management board, the supervisory board and the general assembly of shareholders.
- Establish, in addition, forceful **restructuring tools** for the administrator, including (i) rapid recapitalization of banks without pre-emptive rights of pre-existing shareholders, (ii) conversion of subordinate debt into equity, and (iii) transfer of assets (including businesses and subsidiaries), liabilities, and combined portfolios of assets and liabilities (“purchase and assumption transactions”) to third party acquirers. Consideration should be given to introducing a bank debt restructuring mechanism to restore the bank to viability.
- To facilitate those operations in going concern, it might be useful impose a **selective stay** on certain liabilities.

E. Exit from Crisis Interventions and State Support

55. Exit from state support is proceeding as planned and remains broadly appropriate.⁷

A phased exit is underway, as several financial institutions have partially repaid the state for equity injections following successful capital issuances. Going forward, proceeds from sale of operations (e.g., sale of insurance subsidiaries) also will be used to repay the government. The loan guarantee scheme was allowed to expire at the end of 2010, while the withdrawal of liquidity expansion and deposit insurance will be more gradual, and coordinated within an EU context. The disposal of impaired assets will be more prolonged. In addition, the financial institutions that received support along with the authorities are developing restructuring and divestment plans in conjunction with EC requirements, though full divestment from final shareholdings could take 3–5 years.

⁷ See Dutch State Treasury Agency, Ministry of Finance document, Outlook 2011 (pages 18-21) <http://www.dsta.nl/dsresource?objectid=5650&type=org>.

Table 2. The Netherlands: Risk Assessment Matrix

Threat	Likelihood Considerations	Impact Considerations
Domestic deleveraging	<p>Medium</p> <p>Households are highly indebted. Against this background there is a significant risk of an increase in risk aversion—possibly in response to weaker macroeconomic prosperity or a spreading of problems in the European periphery—that could lead to further declines in activity and a weaker housing market.</p>	<p>High</p> <p>Banks are heavily exposed to housing sector lending. If there is a significant fall in house prices, together with lending arrears, the impact on banks’ balance sheets would be significant.</p>
Lack of understanding of developments and institutions beyond the border	<p>Medium</p> <p>Supervisory colleges are being set up as the vehicle for cross-border supervisory oversight. This leaves domestic systemic oversight by national regulators dependent on the quality of the overseas supervisors, their willingness to share information freely, and a structure that facilitates timely diffusion of information.</p>	<p>High</p> <p>Netherlands banks are very exposed to developments overseas, as shown in the recent global financial crisis. Resource constraints for supervisors, as well as international cooperative agreements, mean that the supervisors may have a relatively limited picture of developments overseas.</p>
Sharp “double-dip” recession	<p>Medium</p> <p>The U.S. and European economies are vulnerable to another sharp contraction in output owing to, in particular, still fragile private sector balance sheets and growing market concerns regarding public debt sustainability.</p> <p>Given strong trade linkages with other European countries, the Netherlands would be exposed to a drop in demand for its exports and consumer and business confidence would be likely to suffer significantly. This could increase strains on bank- asset quality and also hamper bank access to financing, generating a negative feedback loop in the Netherlands and in partner countries.</p>	<p>Medium</p> <p>Bank solvency may be affected by a double dip. Transmission channels could include weak or declining employment levels, which in turn could cause sharp correction in house prices, with an associated impact on the banks and households, as well as rising nonperforming loans from households and corporates more generally.</p> <p>In addition, banks and insurance firms are exposed to a global double-dip recession through foreign subsidiaries. The effect of the difficulties in foreign jurisdictions was demonstrated in the recent crisis, particularly with exposure to sub-prime in the United States.</p>

Slow growth in Europe	<p style="text-align: center;">Medium</p> <p>The accumulation of structural rigidities, fiscal burdens, demographic pressures, problems in the periphery, and general uncertainty could lead to a prolonged period of very low growth in Europe. Unemployment would remain high and rising, investment would be weak, and fiscal crowding out would remain unrelieved. Even some deflation is possible. Bank access to financing could be hampered, further depressing economic activity in the Netherlands and in partner countries.</p>	<p style="text-align: center;">Medium-High</p> <p>Impact considerations are largely consistent with those of the double dip scenario. However, there appears a higher likelihood of slow growth in Europe relative to a double dip; hence the impact consideration is viewed as medium high.</p>
Sustained high sovereign risk	<p style="text-align: center;">Medium</p> <p>The recent rise in spreads on “peripheral” sovereign debt may become entrenched and spread to a wide class of advanced and emerging market countries. Corporate spreads and sovereign-linked assets (such as variable rate mortgages) would be forced up, leading to a deterioration in loan performance.</p>	<p style="text-align: center;">Low</p> <p>The Netherlands seems to be less exposed to the peripheral countries in general than are some of its neighboring countries. Of the European countries, Dutch banking groups report lowest exposure to Greece, Portugal, and Ireland. Nevertheless, while the direct impact of interest rate tiering may be limited, any spread of concerns beyond the peripheral countries could worsen the situation.</p>
Sustained dislocation in funding markets	<p style="text-align: center;">Medium</p> <p>Continued uncertainties about economies in general and the situation of institutions may lead to renewed illiquidity or high premia in funding markets.</p>	<p style="text-align: center;">Medium</p> <p>Dutch banks that are heavily reliant on market funding, including through interbank borrowing, securitization, and the issuance of covered bonds would be most affected, especially if the disruption were sustained. Banks may resort to increased competition for retail deposits, squeezing profitability further. Banks with a funding surplus may also suffer lower returns on excess funds placed in “safe havens.”</p>

Table 3a. The Netherlands: The Core Set of Financial Soundness Indicators for Banks, 2001–10
(In percent)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Deposit takers										
Regulatory capital to risk-weighted assets	11.7	12.0	12.3	12.3	12.6	11.9	13.2	11.9	14.9	13.9
Regulatory Tier 1 Capital risk-weighted assets	8.6	9.1	9.6	9.9	10.3	9.4	10.2	9.6	12.4	11.8
Capital to assets	5.2	5.1	5.0	4.8	3.1	3.0	3.3	3.2	4.3	4.4
Sectoral distribution of loans to total loans										
Residents	72.1	73.8	74.0	73.7	68.7	63.2	59.7	64.4	69.4	67.5
Deposit takers	13.2	14.2	14.6	15.1	1.3	1.6	2.0	3.0	3.3	1.4
Central bank	0.9	0.8	1.1	0.9	1.2	0.9	1.2	1.2	3.6	3.0
Other financial corporations	6.7	8.1	9.2	10.2	12.8	12.1	10.0	10.9	10.9	12.2
General government	3.1	3.2	3.0	2.8	3.1	2.7	2.4	2.7	3.0	3.3
Nonfinancial corporations	19.9	19.0	17.4	16.3	18.1	16.5	17.5	19.3	20.8	21.0
Other domestic sectors	28.3	28.6	28.8	28.5	32.3	29.5	26.6	27.3	27.8	26.7
Nonresidents	27.9	26.2	26.0	26.3	31.3	36.8	40.3	35.7	30.6	32.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Return on assets	0.5	0.5	0.5	0.4	0.4	0.4	0.6	-0.4	0.0	0.3
Return on equity	15.7	11.8	14.8	16.8	15.4	15.4	18.7	-12.5	-0.4	7.1
Interest margin to gross income	56.3	60.1	60.5	58.9	54.1	51.4	52.0	182.6	69.8	70.2
Noninterest expenses to gross income	77.7	80.2	75.5	70.5	70.1	74.0	78.3	223.1	78.1	61.7
Liquid assets to total assets	9.5	10.8	26.6	27.1	26.7	27.3	26.1	21.7	25.8	21.4
Liquid assets to short-term liabilities	179.7	187.4	293.0	302.4	279.4	226.7	226.8	202.1	187.4	176.2
Nonperforming loans net of provisions to capital								35.0	51.8	47.1
Nonperforming loans to total gross loans								1.7	3.2	2.8

Source: DNB

Table 3b. The Netherlands: Financial Soundness Indicators, 2008–10 (7 Largest Banks)
(In percent)

	Dec 31 2008	Dec 31 2009	Jun 30 2010
Return on assets	-0.5	-0.1	0.3
Return on equity	-14.4	-1.4	6.9
Net interest Margin	1.1	1.3	1.4
Cost to income ratio	213.0	75.1	67.8
Loans to deposits	113.3	123.6	121.7
Loans to assets	67.5	71.5	70.5
Government bonds to assets	5.8	6.6	7.3
Investment portfolio to assets	19.7	13.2	14.2
Capital Adequacy Ratio (CAR)	11.5	14.7	13.1
Tier 1 Ratio	9.2	12.1	10.7
Core Tier 1 Ratio	8.4	11.2	9.8
Non-performing loans (NPLs) / Total loans	1.3	2.9	2.2
Loan loss provisions (LLPs) / Total Loans	0.7	1.2	1.1
LLPs to NPLs	55.8	42.3	51.4
Share of top 7 banks to total assets of the Banking system	88	86	85

Source: DNB.

Table 4. Key Scenarios and Variables for the Bank Stress Tests

	Solvency Stress Test Scenarios		Liquidity Stress Tests
	Baseline	Stress Scenarios 1 and 2	
Who performed the stress tests	FSAP team	FSAP team	Authorities
Institutions covered/market share	<ul style="list-style-type: none"> Seven largest banks 85 percent market share 		<ul style="list-style-type: none"> 11 largest banks
Severity of macro-scenarios	October 2010 WEO projections for GDP growth, unemployment, and interest rates.	<ul style="list-style-type: none"> Scenario 1: One SD from baseline for the three macro variables. Scenario 2: Two SD from baseline. 	
Data used	June 2010 bank-by-bank consolidated financial statements and supervisory data.		
Risk horizon	5 years (2011-2015)		12 months.
Metrics (hurdle rates)	<ul style="list-style-type: none"> Tier 1 capital ratio (4%) Tier 1 capital ratio (6%) 		Number of months banks can withstand shocks, accounting for the concentration of liquid assets.
Positions and risk factors included	<ul style="list-style-type: none"> Credit risk in the loan portfolio. Sovereign risk in the banking and trading books. 		Bank run, dry out of wholesale funding markets, and haircuts on liquid assets.
Other Model features	<ul style="list-style-type: none"> Balance sheet approach. Zero credit growth. Normalized net operating income. Zero payout ratio. 		

**APPENDIX I: BASEL CORE PRINCIPLES—SUMMARY
INTRODUCTION**

56. **This is the assessment of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) that were undertaken as part of an IMF Financial Sector Assessment Program (FSAP) Update mission to The Netherlands in November/December 2010, and follows up on BCP assessment performed in the context of 2004 FSAP.⁸**

INFORMATION AND METHODOLOGY USED FOR ASSESSMENT

57. **The assessment was conducted in accordance with the guidelines described in the Core Principles Methodology by the Basel Committee of Banking Supervisors (BCBS).⁹**

58. **The assessment team reviewed the legal framework for banking supervision, held extensive discussions with the staff of De Nederlandsche Bank (DNB), the Authority for Financial Markets (AFM), the Ministry of Finance (MoF), relevant associations and private sector participants in the banking and financial markets.** The team examined the current practice of on and off-site supervision at DNB. The assessment team had the benefit of working with a comprehensive self-assessment completed by DNB, in cooperation with the MoF and the AFM, and received the information it required.

59. **In recent years, several reports evaluated developments during the financial crisis in general and the role of financial supervision by DNB in particular.** Where relevant, observations in these reports have been taken into account in the description of the observance of the criteria and are used to identify the relevant prospective actions to strengthen financial supervision looking forward.

**INSTITUTIONAL AND MACRO—ECONOMIC SETTING AND MARKET STRUCTURE—
OVERVIEW**

60. **The Netherlands has a large and internationally orientated financial sector. Total financial assets of the banking sector amounted (Q2 2010) equal to almost five times GDP.** A quarter of assets is ultimately held by foreign institutions (mostly from within the European Economic Area (EEA)).

61. **The banking sector has been seriously hit by the global financial crisis, which has resulted in unprecedented write-downs on assets, forcing the authorities to take far-**

⁸ The BCP assessment was conducted by Thordur Olafsson (IMF, and former Head of Banking Supervision of the Central Bank of Iceland) and Michael Taylor (Advisor to the Governor of the Central Bank of Bahrain, and formerly Head of Policy, Hong Kong Monetary Authority.)

⁹Basel Committee of Banking Supervision: Core Principles Methodology, October 2006.

reaching measures to maintain financial stability. The direct government financial support amounts to equal to 3.4 percent of GDP. Currently, some of the major banks are in the middle of a restructuring process, which has resulted in a consolidation of their balance sheets, a reduction of their risk profile and an increased domestic orientation. In 2009, the banking sector returned to profitability, which is however still considerably below pre-crisis levels. With the economic recovery expected to be modest and the strengthening of regulation, the banking sector will continue to be confronted with a challenging environment in the years ahead.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

62. **The Netherlands has a strong record and a solid institutional framework supporting the conduct of sound macro-economic policies.** Monetary policy is conducted by DNB within the European System of Central banks (ESCB) framework. Budgetary policy is conducted within a fiscal framework based on predefined rules and within the requirements of the Stability and Growth Pact (SGP).

63. **The Netherland's legal system is based on civil law.** Most financial sector legislation is the result of EU directives, regulations and decisions.

64. **The Netherlands has a well developed business climate with an adequate legal framework including corporate, bankruptcy and private property laws.** Credit institutions must apply either International Financial Reporting Standards (IFRS) accounting principles or the provisions as laid down in the Dutch Civil Code (DCC) (which in itself is largely compliant with the IFRS standards). The auditing profession is subject to self-regulation and to regulation by the AFM. These bodies ensure that the audit profession is subject to licensing and appropriate professional training.

65. **The payment and settlement systems are highly sophisticated and the DNB participates in the various domestic and pan European systems.**

66. **The Netherlands is a market-oriented economy. Market participants have access to essential financial information that is accurate and publicly available.** Investors are free to engage in (financial) contracts. The DCC provides adequate safeguards of property rights and protection against unlawful actions.

67. **The deposit guarantee scheme protects individual depositors up to €100,000.** Currently the scheme is financed ex-post by the financial sector, but plans are being developed to create an ex-ante scheme with risk-based premiums and a more rapid pay out process.

MAIN FINDINGS

68. **The current assessment confirms a high degree of compliance with the BCPs, but weaknesses remain to be addressed.** Since 2004, and particularly as a reaction to the financial crisis the DNB has increased its supervisory capacities, and its ongoing supervision has become

more intrusive. At the same time, cooperation with home and other supervisors within supervisory colleges has intensified.

Objectives, independence, powers, transparency and cooperation (CP 1)

69. **The numerous organizational and legal changes since 2004 have resulted in substantially improved clarity of mandates and objectives for supervisory authorities.** DNB and the AFM appear to possess a clear understanding of their respective roles and responsibilities under the Twin Peaks system, and cooperation and coordination between the two agencies appear to have functioned well in practice, including during the period of greatest financial stress during the crisis. The structure introduced by the AFS does provide for a larger role for the MoF, including rule making authority, than in most other comparable systems.

Licensing and structure (CPs 2–5)

70. **The AFS defines clearly the permissible activities of a bank as well as prohibits institutions, which are not licensed by DNB to pursue the business of banking from using the word “bank” in their name.** The conditions that must be met to obtain a license to pursue the business of a bank are set out in the AFS, as supplemented by the Decree on Prudential Regulation (DPR). The criteria allow DNB sufficient discretion to set conditions and to assess to what extent these conditions have been fulfilled and to determine whether the requested license should be issued.

Prudential regulation and requirements (CPs 6–18)

71. **Capital adequacy rules are based on Basel II, as transposed into EU law by the Capital Requirement Directive (CRD).** The Netherlands legislation provides for the full range of options in respect of advanced and standardized approaches within the CRD, and banks are subject to detailed assessments before being permitted to adopt the advanced approaches with respect to credit, market, and operational risks. The standard Pillar 1 minimum solvency ratio for all banks is 8 percent. In practice, however, banks operate at capital levels that are much higher than the legal minimum.

72. **DNB has had in place a comprehensive set of liquidity rules since 2003.** These are being enhanced in the light of lessons learned from the crisis and will also be amended to incorporate the recommendations contained in Basel 3.

73. **DNB does not set any specific rules with respect to problem assets, provisioning and reserves.** Instead, the level of required provisions is set according to the Expected Loss (EL) estimates calculated in accordance with the IRB approach under Basel II/Capital Requirements Directive (CRD).

74. **DNB does not set any specific limits on exposures to related parties.** DNB argues that provisions of the AFS provide an adequate legal basis for controlling related party lending,

although the referred section does not make a specific reference to such lending. Although the assessors found no evidence to suggest that related party lending is, or has been, a significant issue in the Netherlands, and therefore the relatively informal system of control may be judged effective, it was concluded that the DNB needs to put in place a more formal framework of limits and prohibitions on lending to related parties.

Methods of ongoing banking supervision (CPs 19–21)

75. **DNB’s supervisory approach is risk-based, drawing on a comprehensive Financial Risk Analysis Method, (FIRM), and an associated Risk Analyses Program (RAP).** The FIRM methodology is currently under review to reflect lessons learned from the financial crisis. Prior to the financial crisis, the risk-assessment methodology appears not to have adequately identified the main systemic vulnerabilities, such as increased leverage, increased reliance on wholesale funding, and the acquisition of substantial portfolios of structured securities that lead to the need for public sector capital support. The authorities are taking measures to address these lessons, including closer integration of macro prudential and micro prudential supervision. In addition, as part of its From Analysis to Action (“VITA”) project DNB is also taking steps to enhance the intrusiveness of its supervision and to ensure that it results in adequate follow-up and enforcement actions (“conclusiveness”).

Accounting and disclosure (CP 22)

76. **Netherlands banks are required to compile their financial statements in accordance with either IFRS (for publicly listed banks) or the DCC (for banks that are not publicly listed) the disclosure provisions of which are substantially the same as IFRS.** In practice, many non-publicly listed banks voluntarily apply IFRS. Under the Twin Peaks structure, responsibility for monitoring compliance with accounting and disclosure standards is primarily with the AFM. However, DNB conducts a regular dialogue with both the auditors of individual banks and the accounting profession more generally. It has also established a comprehensive set of disclosure standards for banks based on Basel II, Pillar 3.

Corrective and remedial powers of supervisors (CP 23)

77. **The AFS provides DNB with a comprehensive set of intervention powers.** However, in the past, DNB has not invoked its powers to the full, preferring instead to deal with emerging problems through the use of “moral suasion” rather than formal enforcement measures. While this technique of supervision may have been relatively successful in the past, the evidence suggests that in recent years moral suasion has become a much less effective tool, in part due to changes in the structure and ownership of the Netherlands financial system. DNB has recognized the shortcomings of moral suasion and has embarked on the project VITA to ensure that its supervision becomes more “intrusive and conclusive.”

78. **With regard to resolution powers, DNB currently does not have at its disposal the full range of instruments that are necessary to conduct the orderly resolution of banks.**

Although DNB is empowered to give directions or appoint a special administrator to a problem bank, there exist no instruments to force an orderly resolution without shareholder approval. The MoF and DNB are jointly working on legislation to introduce additional crisis management tools, including the option of being able to transfer deposits of a failing bank to another bank.

Consolidated and cross-border banking supervision (CPs 24–25)

79. **DNB undertakes banking supervision on both a consolidated and on a solo basis in accordance with the CRD.** In practice, supervisory activities are performed on both a consolidated and a solo basis, including quarterly returns provided by the banks, capital adequacy calculations, large exposures, exposures to related parties, and the supervisory review process. DNB has recently taken measures to enhance the functioning of the college of supervisors arrangements in line with the recommendations of the Financial Stability Board (FSB).

80. **Although DNB has the necessary legal and regulatory powers to apply effective consolidated supervision of cross-border banking groups, there have been examples where DNB appears to have relied to a large extent on the supervision exercised by the host supervisor.** Within the current institutional framework and the resulting division of home-host responsibilities as well as the general resources constraint under the risk based approach it would appear that DNB could intensify its capacity towards large, diversified cross-border groups to the degree of intensive scrutiny that their risk profiles warrant.

Table 5. The Netherlands: Summary of Compliance with the Basel Core Principles

Principle	Assessment
Principle 1. Objectives, independence, powers, transparency, and cooperation	No comment.
Principle 1.1 Responsibilities and objectives	No comment.
Principle 1.2 Independence, accountability and transparency	<p>The AFS gives the MoF a substantial role in the rule-making process and it also possesses the powers to overturn specific DNB rules. There is in practice, no evidence of government or industry interference which compromises the operational independence of DNB. However, the circumstances in which these powers could be used need to be more precisely specified to make the process more transparent.</p> <p>The law allows the MoF to play a role in approving DNB's supervisory budget. As further discussed under CP 24, the resources that DNB commits to banking supervision would not appear proportionate to the scale and complexity of the risks arising from this sector. DNB and MoF may want to consider a benchmarking exercise against other countries with banking systems of comparable size and complexity.</p>
Principle 1.3 Legal framework	No comment.
Principle 1.4 Legal powers	No comment.
Principle 1.5 Legal protection	Notwithstanding the discussions that have been taking place between the supervisory authorities and the respective ministries to limit the authorities' prospective financial liability in the event of a law-suit being brought against them, the assessment team is satisfied that the authorities and individual members of staff are adequately protected.
Principle 1.6 Cooperation	No comment.
Principle 2. Permissible activities	No comment.
Principle 3. Licensing criteria	<p>A joint DNB and AFM policy rule on the extended scope of the assessment of fitness and properness came into force on January 1, 2011. The new policy rule will expand, the variables of the assessment, the composition and functioning of the managing and supervisory boards, the information and antecedents that the supervisors will take into account when assessing a person's fitness, and the weighing of the information and antecedents used. The policy rules will further enhance cooperation between DNB and the AFM (such as a joint panel for periodic review of the policy rule). Subsequent amendments to the AFS are being drafted to reinforce the described approach.</p>
Principle 4. Transfer of significant ownership	No comment

Principle 5. Major acquisitions	No comment.
Principle 6. Capital adequacy	The minimum solvency ratio for all banks is 8 percent. In practice, however, banks operate at capital levels that are much higher than the legal minimum. DNB sets capital requirements on a bank-by-bank basis, using an assessment methodology that builds on the Basel II.
Principle 7. Risk management process	No comment.
Principle 8. Credit risk	No comment.
Principle 9. Problem assets, provisions, and reserves	DNB does not set any specific rules in respect of problem assets, provisioning and reserves. Instead, provisioning policies are set on an individual bank basis, in compliance with the requirements of IFRS and DCC, which broadly conforms to IFRS. The primary responsibility for assessing the adequacy of provisions resides with the external auditor. Reliance on accounting standards for loan valuation and provisioning may be reasonable, given high levels of competency and integrity in the Dutch accounting profession. However, the supervisor should consider providing guidance on the definition of default and outline its expectations concerning the level of provisions that would be appropriate when assets are impaired.
Principle 10. Large exposure limits	No comment.
Principle 11. Exposure to related parties	DNB has followed an informal but generally effective approach to controlling related party lending. However, for purposes of full compliance with this CP the supervisor should have in place specific rules detailing the limits and prohibitions on related party lending.
Principle 12. Country and transfer risks	No comment.
Principle 13. Market risks	No comment.
Principle 14. Liquidity risk	DNB has had in place a comprehensive set of liquidity rules since 2003. These are being enhanced in light of lessons learned from the crisis and will also be amended to incorporate the recommendations contained in Basel 3. Currently, reporting forms do not distinguish between liquidity in the major currencies (reporting is in Euros only), and it is recommended that DNB's standardize liquidity reports to permit analysis according to major currencies.
Principle 15. Operational risk	No comment
Principle 16. Interest rate risk in the banking book	No comment.
Principle 17. Internal control and audit	No comment.
Principle 18. Abuse of financial services	It is noted that a number of CP 18-relevant issues as identified by the FATF assessment remain to be addressed.
Principle 19. Supervisory approach	Prior to the financial crisis, the risk-assessment methodology appears not to have adequately identified the main systemic vulnerabilities, such as increased leverage, increased reliance on wholesale funding and the acquisition of substantial portfolios of structured securities, which lead to the need for public sector capital support. The authorities have taken measures to address these shortcomings, including closer integration of macro-prudential and micro-prudential supervisory approaches.
Principle 20. Supervisory techniques	No comment.

Principle 21. Supervisory reporting	For the purposes of off-site supervision, DNB makes substantial use of banks' internal management reports. This practice means that the amounts of data collected in standardized form are relatively limited (e.g., there is no standardized reporting of nonperforming assets) and are at different reporting dates. This makes it difficult to conduct comparative or aggregate analysis (stress tests). With the increased emphasis being placed on macro-prudential surveillance, DNB needs to introduce more standardized and more granular reporting to facilitate this type of analysis. In addition, the standardized data currently collected by DNB is mainly at the consolidated level and does not contain sufficient solo reporting for "relevant entities" that are part of the consolidation group. DNB needs the data to be able to identify risks that arise in particular group companies as well as at the consolidated group level. The required extension of the supervisory reporting framework may imply that DNB's legal powers to collect data need to be extended.
Principle 22. Accounting and disclosure	No comment.
Principle 23. Corrective and remedial powers of supervisors	<p>Although the law provides DNB with a comprehensive set of intervention powers, in the past it has preferred to employ "moral suasion" rather than formal enforcement actions. This technique is becoming increasingly ineffective, as DNB recognizes. An internal project is underway to ensure that formal powers are more widely used.</p> <p>The AFS does not provide DNB with a full range of resolution tools, e.g., the ability to impose restructuring on a bank without shareholder approval. A joint MoF/DNB project is developing amendments to the legislation to provide for a full range of powers.</p>
Principle 24. Consolidated supervision	Although DNB has the necessary legal and regulatory powers to apply effective consolidated supervision of cross-border banking groups, there have been examples where DNB appears to have relied to a large extent on the supervision exercised by the host supervisor. Supervision of large, diversified cross-border groups could be intensified to the degree of intensive scrutiny that their risk profiles warrant. The constraints on supervisory resources noted in relation to CP 1(2) above, may have contributed to this state of affairs. DNB may wish to consider strengthening the resources it devotes to its oversight of subsidiaries located outside the Netherlands, and its practices and procedures for obtaining relevant information concerning their operations and the risks that they pose to the group.
Principle 25. Home-host relationships	No comment.

AUTHORITIES' RESPONSE TO THE BCP ASSESSMENT

The Dutch authorities want to express their appreciation to the IMF and the assessment team for their comprehensive work. The Financial Sector Assessment Program has been a useful exercise. The worldwide experience of the IMF and the use of a common methodology have delivered a useful insight in the current state of financial regulation and supervisory practice in the Netherlands.

The authorities welcome the overall assessment that indicates a high level of observance of banking supervision with the well respected Basel Core Principles of Effective Banking

Supervision. Notwithstanding this good result, the developments in the financial sector and the experience from the global financial crisis continue to call for vigilant action. The recommendations of the IMF are therefore well received and will be considered carefully by the authorities in their continuous efforts for strengthening supervision.

Since the conclusion of the FSAP-mission, several initiatives have already been taken up. As the report already indicates, DNB has initiated a reform program to make its supervisory approach more intrusive and conclusive. This includes the creation of a new supervisory division within DNB since January 2011 that comprises several expertise centers and a separate department with a focus on intervention policy. In addition, the Ministry of Finance has published in March 2011 draft legislation for consultation to strengthen the formal powers of DNB.

In February 2011, DNB has published its supervisory themes for 2011. In addition to its continued focus on strategy and conduct of business, the implementation of the new supervisory framework and strengthening risk management, the further strengthening of data collection has been identified as a specific theme that will require extra attention.

The Minister has recently announced proposals with regard to the institutional framework and the division of responsibilities between the Ministry of Finance and the supervisors. Also, the Ministry of Finance and the Ministry of Justice are exploring the possibilities to limit the liability of the financial supervisors by explicitly laying down the limitation in legislation.

The FSAP-analysis rightfully points out that the Dutch financial sector is characterized by large and internationally orientated institutions. This results in several challenges, as reflected in the recommendations with regard to consolidated supervision and available resources. The recommendations are well received. Progress needs to be realized within the current international institutional framework with the division of supervisory responsibilities between home and host supervisors. In that context, DNB will continue to strengthen its international cooperation, both bilaterally as well as in colleges of supervisors and crisis management groups. In addition, DNB will increase its supervisory resources, as recommended by the IMF, although available resources will remain constrained compared to the size of the financial sector and it will continue to be necessary to set priorities on the basis of a risk-based approach.

With regard to the assessment of BCP-principle 11 ("exposures to related parties"), DNB notes that its current practice contains more than an informal approach based on moral suasion (paragraph 60). As part of the FINREP reporting requirements, institutions are required to report a standardized table to DNB on a regular basis. Moreover, institutions must assess and disclose the exposures to related parties in their annual accounts. As such, these exposures form an integral part of the annual discussion between DNB and the external

auditor. The exposures will be assessed against the background of controlled and sound business operations. This enables DNB to establish that the credit institution has adequate limits with respect to intra group exposures. We have provided the IMF with evidence that this approach is actively enforced with use of its formal powers under the AFS.

**APPENDIX II: IOSCO CORE PRINCIPLES—SUMMARY
INTRODUCTION AND METHODOLOGY**

81. **An assessment of the level of implementation of the IOSCO Principles in the Netherlands securities market was conducted from November 25 to December 14, 2010 as part of the Financial Sector Assessment Program (FSAP) by Ana Carvajal, Monetary and Capital Markets Department.** The assessment was conducted based on the IOSCO Principles and Objectives of Securities Regulation and its Methodology adopted in 2003 and updated in 2008.¹⁰

DESCRIPTION OF THE REGULATORY STRUCTURE

82. **The AFM is the primary authority responsible for the supervision of securities markets in the Netherlands, with the participation of DNB in prudential supervision.** In addition to its responsibility in conduct supervision, the AFM has specific responsibilities stemming from other laws: (i) Supervision of statutory auditors; (ii) Supervision over financial reporting by issuers; and (iii) consumer protection in relation to mainly exempted issuers that engage in “abusive” offerings. The AFM does not have the mandate to hear individual complaints of customers. Rather this is a mandate of the Financial Services Complaint Tribunal (KIFID) and the Financial Ombudsman.

83. **Exchanges, Multilateral Trading Facilities (MTFs), and central clearing counterparties (CCPs) have a limited role in oversight of the Dutch market.** All of these infrastructure providers are subject to the (indirect) oversight of the AFM and DNB. There are Memoranda of Understanding (MoUs) in place among the regulators of the countries where Euronext and LCH Clearnet SA operate to ensure coordination of such oversight.

MARKET STRUCTURE

84. **As of October 2010, there were 115 companies listed in Euronext Amsterdam, for a total market capitalization of €462.712 millions.** The market is highly concentrated. The top ten companies represent roughly 74 percent of total market capitalization. The bulk of new listings in Euronext take place in the Paris segment.

85. **As of November 2010 there were 49 banks and 263 investment firms**—of which 243 were located in the Netherlands—authorized to carry out investment services in the Netherlands. Overall banks (or their investment firms’ affiliates) are the main participants in the securities markets, in terms of trading volumes and assets under management. Approximately 90 percent of

¹⁰ In 2008 IOSCO only updated the footnotes of the Methodology. In June 2010 IOSCO approved a revision to the IOSCO Principles, which mainly resulted in the addition of nine new Principles. However, a revised methodology has not been developed yet. As a result this assessment has been conducted based on the current methodology.

the investment firms are dedicated to asset management. The remaining investment firms trade on their own account, are market makers or give advice. The majority of the investment firms are not leveraged.

86. **As of November 2010, there were 120 firms licensed to manage CIS.** 113 were located in the Netherlands; of which 93 are management companies, and 20 are investment companies. These firms have a total of 389 CIS under management, of which 55 are umbrella funds with a total of 559 sub funds. There are roughly 800 foreign CIS authorized in the Netherlands.

87. **Assets under management (AUM) by CIS reached €392 billion at end 2009.** The bulk of the CIS authorized in the Netherlands are non-UCITS (Undertakings for Collective Investment Schemes in Transferable Securities). Bond funds make the largest segment of the Dutch investment fund industry (43 percent) followed by equity funds (42 percent). The share of Dutch pension funds in the holding unit of Dutch investment funds rose from 44–76 percent at end 2009.

88. **The main market in the Netherlands is Euronext Amsterdam, which is operated by Euronext Amsterdam, a fully owned subsidiary of Euronext NV.** Euronext NV operates Eurolist and Liffe Connect. Eurolist is a cash market that integrates the markets of Brussels, Paris, the Netherlands, and Lisbon into a single market with the same rules for access as well as listing requirements. Starting in 2010 it has also integrated a cash market from London through the London gateway. Settlements are made via Euroclear in a DVP T+3 basis. Liffe Connect is a regulated market for derivatives. For both markets LCH Clearnet S.A., a bank registered under French Law, provides central counterparty and clearing services.

89. **There are also three MTFs licensed in the Netherlands: New York Stock Exchange (NYSE) Arca Europe, Alternext, and TOM.** The first two are operated by Euronext. NYSE Arca Europe operates a central limit order book for trading blue chips stocks from 14 countries. Alternext is an alternative market for medium size companies. TOM is a MTF for cash markets recently licensed; and currently in the process of obtaining a license to operate also a MTF for derivatives.

GENERAL PRECONDITIONS FOR EFFECTIVE SECURITIES REGULATION

90. **There are a number of general preconditions necessary for the effective regulation of securities markets that appear to be in place in the Netherlands.** There are no significant barriers to entry and exit for market participants. The legal and accounting system supports the implementation of requirements and effective regulation of market participants. The commercial law is up-to-date, and so are corporate governance standards. The legislation regarding insolvency is sophisticated. The regulators have legally enforceable powers of decision and action. The taxation framework is supportive to the operations of the industry in the jurisdiction.

MAIN FINDINGS

91. **Principles for the regulator (Principles 1–5):** The supervisors work under a clear legal framework. In practice the AFM and DNB enjoy operational independence; however certain features of the legal framework could pose threats to such independence. Both the AFM and DNB operate under a strong framework of accountability. Overall the AFM and DNB have sufficient powers to supervise the securities markets. However their limited rulemaking authority can affect their ability to react swiftly to market developments. The AFM also has limited powers to enforce issuers' compliance with financial reporting standards. The AFM has had sufficient resources to carry out its mandate. The resources dedicated by DNB to supervise securities intermediaries appear to be limited. Decisions of the DNB and AFM that affect third parties are subject to judicial review.

92. **Principles for self-regulation (Principles 6–7):** Exchanges and central clearing counterparties perform certain oversight functions over their members. As providers of infrastructure services they all have been subject to the oversight of the AFM (exchanges) and the AFM and DNB (central clearing counterparties).

93. **Principles for enforcement (Principles 8–10):** The AFM and DNB have extensive investigative powers over regulated entities, as well as third parties. Both the AFM and DNB have at their disposal a wide range of enforcement measures, including public warnings, instructions, orders for incremental penalties and administrative fines. Supervision and enforcement appear to be effective; however there are limitations in two areas: prudential supervision of management companies and criminal enforcement.

94. **Principles for cooperation (Principles 11–13):** The AFS requires the AFM and DNB to cooperate with each other. It also requires them to cooperate with and provide assistance to foreign regulators. For such purposes they can use the same investigative powers that they have for purposes of conducting their own investigations. The AFM is signatory of the IOSCO Multilateral Memorandum of Understanding (MMoU), as well as many bilateral MoUs. DNB is also signatory of multiple bilateral MoUs. International cooperation is largely centralized in the AFM. There is ample evidence of the AFM's capacity and willingness to cooperate with foreign regulators.

95. **Principles for issuers (Principles 14–16):** Issuers are required to submit a prospectus for the approval of the AFM, which content is in line with the IOSCO principles. They are also required to submit annual and semi-annual reports and to communicate price-sensitive information. Financial statements must be prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in EU for issuers that consolidate. Auditors that conduct statutory audits are subject to the oversight of the AFM. The framework requires that auditors be independent. The AFM has limited powers to enforce issuers' compliance with financial reporting standards. The system to enforce compliance with the obligation to launch a mandatory tender offer, or to pay a fair price is based on a private right of action. The AFM has authority to

enforce compliance with procedural aspects related to the tender offer, including the approval of the offering memorandum.

96. **Principles for collective investment schemes (Principles 17–20):** Management of collective investment schemes is subject to licensing. Licensing requirements include fit and proper requirements, as well as compliance with a set of operational requirements aimed at ensuring sound and controlled business. Management companies are also subject to minimum capital requirements, but only UCITS management companies are subject to a solvency ratio and review of qualifying holdings. CIS constituted as unit trusts are required to have an independent depository; while there are other safeguards for CIS constituted as investment companies. Management companies are required to submit annual and semi-annual records, but there are no additional reporting requirements for prudential supervision. DNB supervision of management companies is mostly off-site. The AFM has developed a risk-based supervisory program that appears to be working well. CIS must have a prospectus, which content is in line with the IOSCO Principles. The AFM has limited authority to intervene in a non-UCITs offering.

97. **Principles for intermediaries (Principles 21–24):** The provision of investment services or investment activities requires a license. Licensing requirements include fit and proper requirements, as well as compliance with a set of operational requirements aimed at ensuring sound and controlled business. Investment firms are subject to minimum capital requirements. DNB receives quarterly and monthly reporting to supervise compliance with prudential requirements. Both the DNB and the AFM have developed risk-based supervisory programs for the supervision of investment firms. Such programs appear to be working well. Investment firms have several obligations vis-à-vis their customers in relation to information disclosure and suitability. In addition they are required to hold their assets on bank accounts under strict rules of segregation. The AFM has developed a plan to deal with the event of their insolvency. There is also an investor compensation scheme. Insolvency of an investment firm is subject to the framework applicable to corporations.

98. **Principles for secondary markets (Principles 25–30):** Both regulated markets and MTFs are subject to licensing and oversight. Currently most of its supervisory resources are dedicated to Euronext. Arrangements for the cross-border supervision of Euronext NV appear to be working well. Market manipulation and insider trading can be pursued administratively or in the criminal courts. The AFS requires pre and post-trade transparency for equity markets, for regulated markets (RM), and MTFs. Post trade transparency is required for Over the Counter (OTC) in shares, and systematic internalizers. There are no transparency requirements for other markets. LCH Clearnet S.A. has mechanisms to address large exposures, including intraday margining.

Table 6. The Netherlands: Summary of Implementation of the IOSCO Principles

Principle	Assessment
Principle 1. The responsibilities of the regulator should be clearly and objectively stated.	The responsibilities of the AFM and DNB are clearly established by law, mainly in the AFS. The mandates are also well understood by market participants, and there do not appear to be gaps or inequities. The AFS requires the AFM and DNB to cooperate with one another. They have signed a covenant. There is also a covenant for coordination in regard to criminal enforcement with the Public Prosecution Office and the Financial Investigations Unit.
Principle 2. The regulator should be operationally independent and accountable in the exercise of its functions and powers.	In practice the AFM and DNB enjoy operational independence; however certain features of the legal framework could pose threats to such independence. The legal framework provides for a high degree of accountability to the MoF and the public. The authorities have to submit annual reports to the MoF both on the performance of their duties and the budget, which are in turn submitted to Parliament. Decisions of the AFM and the DNB that affect third parties are subject to judicial review.
Principle 3. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	The supervisors have licensing powers, as well as broad supervisory and enforcement powers. Their limited rulemaking authority can affect their ability to react swiftly to emerging risks. The AFM has limitations in its powers vis-à-vis issuers, and licensing of regulated markets is still retained by the MoF. The AFM has the necessary resources to carry out its functions; while the resources of DNB for the supervision of securities intermediaries appear to be limited.
Principle 4. The regulator should adopt clear and consistent regulatory processes.	Both the AFM and DNB are subject to general obligations of fairness, based on the General Administrative Law Act.
Principle 5. The staff of the regulator should observe the highest professional standards.	The AFM has developed an integrity policy aimed at ensuring high professional standards. Such policy deals with issues such as insider trading, confidentiality, ancillary activities, etc. Compliance with the policy is monitored by the Compliance and Integrity Department which conducts reviews of staff on a risk-basis, and of Board Members and high management of an annual basis. DNB's integrity policy is similar to that of the AFM. Monitoring of compliance is also vested in the Compliance and Integrity Department.

Principle	Assessment
<p>Principle 6. The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets.</p>	<p>There are no organizations with legal power to set up general binding rules of eligibility for participation in securities markets activities, or to ban a person from participating in securities activities, other than the AFM and DNB. DSI and DUFAS are becoming increasingly involved in raising the professionalism of participants in the Dutch securities market. However their rules do not have the “binding” nature required by the principles to consider them SROs for the purposes of this assessment. The exchanges, MTFs and central clearing counterparties have some oversight role over members.</p>
<p>Principle 7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.</p>	<p>Exchanges, MTFs, and central clearing counterparties have been subject to oversight by the financial supervisors. Furthermore the AFM has entered into MoUs with the regulatory authorities of the countries where Euronext and LCH Clearnet S.A. operate,</p>
<p>Principle 8. The regulator should have comprehensive inspection, investigation, and surveillance powers.</p>	<p>The supervisors have broad supervisory, investigative and enforcement powers over regulated entities. The AFS requires regulated entities to keep records, including records on transactions for a period of five years. Regulated entities are required to have in place mechanisms to minimize AML. In particular they are required to conduct customer due diligence and to report suspicious transactions.</p>
<p>Principle 9. The regulator should have comprehensive enforcement powers.</p>	<p>The supervisors have broad powers to request information, inspect business documents, and enter into business premises of third parties. They can also take testimony. Although they cannot take it under oath, failing to attend a request or not attending it truthfully constitutes a criminal offense. Both supervisors have a range of enforcement measures to address violations to securities laws and regulations including public warnings, instructions, orders for incremental penalties and administrative fines (which can reach a maximum of €8 million).</p>
<p>Principle 10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.</p>	<p>Overall the supervisors have implemented a credible and effective supervisory and enforcement program. However, DNB should achieve a better balance between off site and onsite supervision in particular for management companies. Criminal enforcement appears not to be effective enough; at least the results are not always visible.</p>

Principle	Assessment
<p>Principle 11. The regulator should have the authority to share both public and nonpublic information with domestic and foreign counterparts.</p>	<p>The AFM and DNB are subject to general obligations to cooperate with one another, as well as specific areas where such cooperation is required, in the form of exchange of information, notification or even consultation to one another. The AFS also requires them to cooperate with foreign regulators. The system differentiates between regulators from EU member states, for which this obligation even entails instances where consultation is required, and other non EU states. In both cases there is a general obligation to exchange information.</p>
<p>Principle 12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.</p>	<p>There is a covenant between the AFM and DNB that further details their obligations to exchange information, consult one another and cooperate. The AFM is signatory of the IOSCO MMOU, and to multiples bilateral MoUs. DNB is also signatory to multiple MoUs.</p>
<p>Principle 13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.</p>	<p>The AFS allows the AFM and DNB to provide assistance to both supervisors from Member States as well as non-Member States. To do that, they have the same investigative powers that the AFS provide them to carry out their own investigations. International cooperation is largely centralized in the AFM. There is ample evidence of the AFM's capacity and willingness to cooperate with foreign regulators.</p>
<p>Principle 14. There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions.</p>	<p>Issuers who want to offer securities to the public or have them admitted to trading are required to submit a prospectus for approval of the AFM. In addition, issuers admitted to trading are required to present annual and semiannual reports. They are also required to communicate material events as soon as possible. The AFM has developed guidance to assist issuers in complying with the latter obligation.</p>
<p>Principle 15. Holders of securities in a company should be treated in a fair and equitable manner.</p>	<p>The Dutch Civil Code (DCC) provides for a framework for shareholders rights. The system requires mandatory tender offers by the person that has acquired 30 percent of the shares (or control over them) of a listed company, the mandatory tender offer must be directed to the remaining shares and the price must be fair. The AFM is in charge of supervising that the mandatory tender offer meets the requirements set forth in the AFS. It does not have the power to file a suit if the person failed to launch a tender offer in spite of meeting the threshold, nor if the price offered is not fair. The company or shareholders themselves can file such suit.</p>

Principle	Assessment
<p>Principle 16. Accounting and auditing standards should be of a high and internationally acceptable quality.</p>	<p>Issuers that are required to consolidate must prepare their annual and semi-annual financial statements according to IFRS as adopted in EU. Foreign issuers are allowed to use US, Canadian, or Japanese GAAP.</p> <p>Auditors must apply the auditing standards approved by the Dutch Auditing Association, which are almost identical to the International Standards of Auditing (ISA). The AFM has limited powers to supervise issuers' compliance with financial reporting standards.</p>
<p>Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.</p>	<p>Management of CIS requires a license by the AFM. Eligibility standards include fit and proper requirements, as well as compliance with a set of operational requirements aimed at ensuring sound and controlled business. Management companies are also subject to capital requirements, but only UCITS management companies are subject to solvency ratio and review of qualified holdings. Reporting requirements are not sufficient to support prudential supervision. DNB relies almost entirely on off-site supervision for the prudential supervision of management companies and CIS. The AFM conducts both thematic and institution based on-site inspections, the latter on high impact firms, on a one year cycle.</p>
<p>Principle 18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	<p>CIS can be constituted as an investment company (usually a limited company) or as a trust. In both cases the law clearly establishes the rights of unit holders, as well as the separation of the assets of the unit holders. The prospectus must provide information in regard of the structure and its risks. Only CISs constituted as unit trusts are required to have an independent depository, but there are other safeguards for CIS constituted as investment companies.</p>
<p>Principle 19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p>	<p>CIS are required to issue a prospectus, which should include all the information necessary for investors to form an opinion about the risks, costs and structure of the CIS. A risk factor must be included in the prospectus and the Financial Information Leaflet. Prospectus for UCITS are subject to approval by the AFM; while in the case of non-UCITS the AFS requires a certification by an external auditor on compliance of the prospectus with regulatory requirements, for purposes of registration. However, the AFM has limited authority to intervene in a non-UCITS offering (through the registration process).</p>

Principle	Assessment
<p>Principle 20. Regulation should ensure that there is a proper and disclosed basis for assets valuation and the pricing and the redemption of units in a collective investment scheme.</p>	<p>The prospectus must include information about the method used to calculate the net asset value, the frequency of such calculation and the currency used. If applicable, it must include information about the method used to calculate the price at which the unit will be offered, repurchased, or redeemed. Prices of illiquid assets must be evaluated by an independent expert on an annual basis. The AFM has issued guidance on the valuation of illiquid assets. The prospectus must also state the conditions for redemptions, as well as suspensions of redemption.</p>
<p>Principle 21. Regulation should provide for minimum entry standards for market intermediaries.</p>	<p>The provision of investment services or investment activities requires a license by the AFM. Banks can also provide such services, without the need for a license from the AFM, but they are required to meet the same eligibility requirements than investment firms, and the AFM must be consulted. Eligibility standards include fit and proper requirements, as well as compliance with a set of operational requirements aimed at ensuring sound and controlled business. The AFM conducts both thematic and institution based on-site inspections, the latter on high-impact firms, on a one year cycle.</p>
<p>Principle 22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.</p>	<p>Investment firms are subject to minimum capital requirements. They are also subject to a solvency ratio, in similar terms than banks. DNB receives quarterly and monthly reports to supervise compliance with prudential requirements. It conducts on-site inspections of high impact firms (roughly 25 percent of the firms) under a one year cycle. All other firms are visited under a three year cycle. Visits do not necessarily entail the same level of scrutiny than an on-site inspections.</p>
<p>Principle 23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.</p>	<p>Investment firms are required to have a risk management function, a compliance function and an internal control function. In the latter two cases the respective departments must be independent from management, and are required to report to the board of the company on their findings on an annual basis. Investment firms have several obligations vis-à-vis their customers in relation to information disclosure and suitability, and best execution. In addition they are required to hold their assets on bank accounts under strict rules of segregation. All such obligations apply equally to banks that provide investment services.</p>
<p>Principle 24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</p>	<p>The AFM has developed a plan to deal with the eventuality of a failure of a financial institution. There is an investor compensation scheme in place. The resolution of an investment firm is done under the general framework for corporate insolvency.</p>

Principle	Assessment
<p>Principle 25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.</p>	<p>The operation of a regulated market or a multilateral trading facility is subject to licensing. In the first case by the MoF on recommendation of the AFM. In the latter by the AFM, as part of the license for an investment firm. The framework provides a level playing field for MTFs vis-à-vis regulated markets, in relation to their operational requirements.</p>
<p>Principle 26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p>	<p>The AFM conducts real time supervision of Euronext Amsterdam, as well as supervision on T+1 basically aimed at detecting market abuse and insider trading. The supervisors of Belgium, the U.K., France, and Portugal recently signed a revised MoU that established the arrangements for a coordinated approach to the supervision of Euronext N.V. Such arrangements have allowed for approvals to be decided collectively, as well as for a coordinated approach to on-site inspections. The AFM has also established mechanisms to oversee ENDEX and the MTFs licensed by it, such as reporting obligations and meetings with the Board.</p>
<p>Principle 27. Regulation should promote transparency of trading.</p>	<p>The AFS requires pre-and post-trade transparency on shares for RM and MTFs; and post-trade for systematic internalizers and OTC. A consolidated tape is under review. There are also concerns about the waivers on transparency connected to large trade blocks. There are no transparency requirements for other markets, but there appears to be a good level of transparency in the corporate and government bond markets.</p>
<p>Principle 28. Regulation should be designed to detect and deter manipulation and other unfair trading practices.</p>	<p>Insider trading and market manipulation constitutes both an administrative infraction and a criminal offense. Both misconducts are described in broad terms, and apply not only to securities and derivatives but to any financial product. The AFM coordinates with other supervisors through its MoUs but also in the context of Europe through CESR-Pol.</p>
<p>Principle 29. Regulation should aim to ensure the proper management of large exposures, default risk, and market disruption.</p>	<p>DNB and the AFM jointly supervise securities clearing and settlement. They do not directly monitor large exposures, but they do receive monthly information from LCH Clearnet S.A. on such positions. LCH Clearnet S.A. on the other hand, has mechanisms to address large exposures, including intraday margining.</p>
<p>Principle 30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.</p>	<p>Not assessed.</p>

Table 7. The Netherlands: Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 2	<ul style="list-style-type: none"> • The MoF should consider further clarifying the conditions under which the powers to take back a function or set aside rules of the supervisors would be exercised. • A legal reform should be pursued to incorporate specific provisions for the adequate legal protection of the supervisory authorities against legal suits in the AFS.
Principle 3	<ul style="list-style-type: none"> • A legal reform should be pursued to expand the rule-making authority of the AFM and DNB. • A legal reform should be pursued to strengthen the powers of the AFM in relation to issuers as described in Principles 15 and 16. The licensing of regulated markets should be a responsibility of the AFM. • DNB should review whether enough resources have been allocated to the prudential supervision of securities intermediaries.
Principle 6	<ul style="list-style-type: none"> • The DSI is performing a critical role for the securities industry, although currently on a voluntary basis. In the medium term the AFM could evaluate whether a more formal SRO arrangement is necessary. That would allow the AFM to rely more on the DSI, while at the same time subjecting it to oversight. In such case, a reform to the AFS—to incorporate a regime for SROs—would be warranted.
Principle 9	<ul style="list-style-type: none"> • The MoF jointly with the AFM might wish to review whether assignment of some of additional investigative powers to the AFM as detailed in Principle 9 could further enhance its enforcement capacity. • The AFM should review whether to allow for disclosure of enforcement actions, even before a decision has been taken, on a more general basis.
Principle 10	<ul style="list-style-type: none"> • DNB should strike a better balance between off and on-site supervision of management companies. • DNB should periodically assess the balance between visits and on-site inspections for investment firms. • The AFM, DNB and the MoF should coordinate with the PPO to review whether enough disclosure exists in connection with criminal enforcement, and whether additional resources are needed for criminal enforcement of securities laws.
Principle 14	<ul style="list-style-type: none"> • A legal reform should be pursued to increase the threshold of €50,000 used for purposes of exempting an issue from the requirement of a prospectus. The authorities informed that EU members have agreed to increase the amount to €100,000.
Principle 15	<ul style="list-style-type: none"> • A legal reform should be pursued to establish additional mechanisms to enforce compliance with the mandatory tender offer and the fair price obligation, e.g., providing the AFM directly with the authority over these issues or the authority to file suits before the Enterprise Chamber of the Amsterdam Court of Appeals.

Principle	Recommended Action
Principle 16	<ul style="list-style-type: none"> • A legal reform should be pursued to strengthen AFM’s authority to enforce compliance with accounting standards. Such reform should properly address the limitations described in this Principle, in particular: (i) the limitations in the authority of the AFM to request information from issuers; (ii) the tight schedule under which the AFM has to file the suits before the Enterprise Chamber of the Court of Appeals; (iii) the limitations to share information among departments of the AM, and (iv) the need to request the review of the whole financial report when filing a suit to enforce compliance with the publication of a recommendation. • The MoF jointly with the AFM should consider extending IFRS to issuers that are not required to consolidate.
Principle 17	<ul style="list-style-type: none"> • A legal reform should be pursued to remove the licensing exemption for management companies who only offer units below €50,000. The authorities stated that this exemption will be removed with the implementation of the Alternative Investment Fund Managers (AIFM) Directive. • A legal reform should be pursued to eliminate the differences in capital requirements and review of qualifying holdings for UCITs management companies’ vis-à-vis non-UCITs management companies. • A legal reform should be pursued to provide DNB with the authority to impose reporting requirements on CIS and their management companies for purposes of prudential supervision. • The MoF jointly with the AFM should consider extending IFRS to all CIS. • DNB should reach a better balance between off-site supervision and on-site inspections of management companies. • The AFM should periodically assess the balance between thematic and institution based inspections.
Principle 18	<ul style="list-style-type: none"> • A legal reform should be pursued to require all CIS to have an independent depository. In adopting a common approach for all CIS the authorities might wish to consider strengthening the requirement to have a “depository” by imposing that it be a licensed entity, such as a credit institution, and providing it with broader oversight/custodial functions.
Principle 19	<ul style="list-style-type: none"> • A legal reform should be pursued to provide the AFM with more clear powers to “intervene” or “hold-back” an offering as required by the Principles. In connection with it, the AFM jointly with the MoF should review whether the system of “certification” by external auditors has provided a comparable level of “oversight” as the vetting process of the AFM.
Principle 20	<ul style="list-style-type: none"> • The AFM and the MoF might wish to explore whether rules on the conditions for open-end funds should be developed. The authorities should also explore whether specific rules are needed in connection with suspensions of redemptions.
Principle 21	<ul style="list-style-type: none"> • The assessor welcomes the legislative initiative to establish a suitability requirement for directors, which would strengthen the current fit and proper requirements by allowing the supervisors to carry out a more comprehensive assessment that includes specific competences.

Principle	Recommended Action
Principle 24	<ul style="list-style-type: none"> • The assessor welcomes the initiative of the AFM to seek mechanisms to receive timely information from KIFID in relation to complaints received against individuals and firms, since this is critical input for a risk-based supervisory approach. • The AFM and DNB should conduct scenario analysis and crisis simulations exercises, which could eventually help them to determine whether improvements are needed to the plan developed by the AFM, or to their covenant.
Principle 25	<ul style="list-style-type: none"> • The AFM should include the guidance on licensing of regulated markets in its website, once it is finalized.
Principle 27	<ul style="list-style-type: none"> • The AFM should continue to actively engage in the MiFID review process to improve market quality and transparency of equity market trading in a competitive multi trading venue environment. In particular, the AFM and MoF should continue to contribute to the European reforms pursued to address concerns regarding the waivers on transparency for block trades. In the same manner, a consolidated tape should also be pursued to enhance post trade transparency. • A legal reform should be pursued to impose reporting requirements on OTC derivatives markets. The MoF jointly with the AFM should review whether addition transparency is needed in other markets, including government and corporate bond markets.
Principle 28	<ul style="list-style-type: none"> • A legal reform should be pursued to allow for the implementation of the client-ID in the Netherlands in order to help the AFM to reduce the duration of its investigations; therefore contributing to the overall effectiveness of its market surveillance. • The AFM jointly with the MoF should consider whether additional investigative powers for the AFM to access telephone and internet service providers' records are desirable. • Strengthening of CESR- Pol is desirable. In the long run further centralization of supervision might be necessary.
Principle 29	<ul style="list-style-type: none"> • A comprehensive legal framework for clearing and settlement should be adopted.

AUTHORITIES' RESPONSE TO THE IOSCO ASSESSMENT

The authorities of the Netherlands would like to express their appreciation to the IMF and the assessment team for their effort, time and resources spent to prepare the Financial Sector Assessment Program of the Netherlands. The FSAP has been a useful exercise and has given the authorities insight in the current state of the regulatory framework and the supervisory practice in the Netherlands as well as the risks in the financial sector. The authorities would also like to thank the IMF for the fruitful conversations on the importance of addressing risks that could harm the financial sector and the public and the discussions on how to see to these risks effectively on national and European level. The authorities believe that the European and international cooperation will benefit from the FSAP conducted by the IMF, as it will prove to be a valuable tool for countries and international bodies to understand, compare and learn from other regulatory frameworks and practices.

We are grateful for the opportunity to comment on the findings and recommendations in the assessment. The authorities are pleased with the overall outcome that the Netherlands exhibits high level of implementation of the IOSCO Principles. The AFM has gained a reputation of a credible and effective enforcer in the field of conduct-of-business. This is the result of its focus on a clear risk-based enforcement strategy. Prudential supervision is considered reasonable and credible.

The assessment has also identified some areas for improvement. This is currently under review by the AFM, DNB and the Ministry of Finance. In this regard, the Ministry of Finance will send the Parliament an official statement on the specific areas where the authorities will take action in response to the recommendations of the IMF.

The authorities have taken good notice of the findings and the comments of the assessor. With a single exception, all principles are fully or broadly implemented, which reflects that the objectives of the core principles are adequately met. With regard to the principles 3, 10, 15, 16, 17, 18, 19 and 27, the authorities note that these principles are not fully implemented in this assessment in comparison with the FSAP in 2004. The authorities would like to emphasize that this is the result of the fact that the financial crisis has put the standard of observance in a different perspective. As a result, the regulatory framework and practice in the Netherlands was subject to a more stringent assessment of the IMF compared to the FSAP in 2004. The authorities agree with the IMF that supervisors worldwide should raise the bar to higher levels. However the authorities would like to stress that the assessment should by no means be interpreted as an indication that the supervisory framework exhibits a lower level of observance compared to the FSAP in 2004. On the contrary, supervision has been strengthened over the years: the AFM has since 2006 been given more supervisory tasks and broader powers, for example in the areas of financial reporting and supervision of auditors.

In conclusion, the authorities believe that the findings of the IMF are in line with current practice and will review and further take into account the recommendations. In light of the importance to cooperate at European and international level to enhance the regulatory system and practice, the authorities look forward to continue the discussions with the IMF and other regulators worldwide to take on the challenge to build a stronger and more robust framework for the financial sector.

APPENDIX III: IAIS CORE PRINCIPLES—SUMMARY**INTRODUCTION**

99. **This assessment provides an update on the significant legislative changes and regulatory developments in the insurance sector of the Netherlands since 2004.**¹¹ The current assessment was conducted from November 22–December 14, 2010. The Netherlands undertook an initial Financial Sector Assessment Program (FSAP) in 2004, which included a formal assessment of the Netherlands with the ICPs. The recommendations arising from the 2004 assessment were largely addressed. Both the initial FSAP and the current assessment are benchmarked against the ICPs issued by the International Association of Insurance Supervisors in 2003. The assessment is based on the laws, regulations, and other supervisory requirements and practices that are in place at the time of assessment.

100. **The Netherlands has adopted the ‘Twin Peaks’, a functional cross-sectoral approach to regulation and supervision,** which was implemented in a phased approach as from 2002. Under the functional approach, the Netherlands Central Bank (DNB) takes charge of prudential supervision while the Authority for Financial Markets (AFM) is responsible for conduct-of-business supervision. The division of responsibilities between DNB and AFM is defined by the Act on Financial Supervision. In addition, a covenant between the DNB and the AFM facilitates the legal framework for supervisory cooperation. The covenant also facilitates the implementation of the designation of a lead supervisor i.e., DNB generally leads the supervision of banks, insurers, and pension funds, while the AFM leads for securities firms.

101. **The Act on Financial Supervision (Wft) provides a consolidated legal framework for supervising the financial sector in Netherlands.** The shift towards the Twin Peaks supervisory approach is supported by the reform of the legislative framework for the financial sector. The Wft came into force on January 1, 2007, replacing seven supervisory statutes, which were structured along the traditional sectoral lines. Where appropriate, the Wft introduces cross-sectoral rules to replace the relevant sectoral rules.

102. **DNB’s Supervisory Strategy for 2010-2014 incorporates the key lessons learned from the financial crisis of 2008/2009.** DNB has implemented tighter supervision by adopting a supra-institutional approach in its macro-prudential supervision, to complement the traditional micro-prudential supervision at the institutional level. DNB is also devoting more attention to institutions’ business models and strategies as well as their culture and conduct. DNB established two new departments in January 2011; an Intervention Department specializes in dealing with troubled institutions and a Risk Management department ensures

¹¹ The Assessment was conducted by Su Hoong Chang, Insurance Supervision Advisor, contracted by the IMF, and Rodolfo Wehrhahn, Technical Assistance Advisor, IMF.

the orderly implementation of DNB's enhanced supervisory approach through peer reviews and assessment of whether supervisors are correctly assessing risks.

KEY FINDINGS AND RECOMMENDATIONS

103. The authorities have made significant progress in updating its regulatory framework and addressing the recommendations arising from the ICP assessment in 2004.

With the implementation of the 2006 Act for Financial Services, which is incorporated into the Wft, the authorities have addressed almost all the 2004 recommendations. The "twin peaks" supervisory structure and the Wft provide clarity to the authorities' supervisory mandates. The Wft and related regulations establish clear regulatory requirements for licensing, corporate governance, internal controls, group-wide supervision, technical provisions, and supervision of intermediaries as well as consumer protection. The remaining weaknesses relate more to inadequate legal authority of DNB in supervising insurance groups. Both the DNB and the insurance industry publish extensive industry and institution-specific data, contributing to more effective market discipline.

104. While the updated regulatory framework in the Netherlands has a high level of observance with the ICPs, effective implementation is in transition. DNB has introduced the *Financial Institutions Risk Analysis Method (FIRM)* framework and macro-prudential supervision to strengthen its risk-based supervision and market analysis. Drawing from the lessons learned from the financial crisis in 2008/2009, DNB has also embarked on more intrusive supervision of insurers' business models and strategies, as well as their culture and conduct to better understand their operations and risks. The impending implementation of Solvency II in 2013 will enhance DNB's risk-based supervision.

105. For effective implementation of the enhanced supervisory regime, it is important for the supervisory authorities to be adequately resourced and empowered. While their supervisory staffs are competent and qualified, the authorities are advised to review the adequacy of supervisory resources particularly for effective supervision of internationally active insurance groups and implementation of Solvency II. There is scope for broadening the legal authority of DNB and the AFM, not just to set rules within the current legal parameters established by the MoF, but at a sufficient level to facilitate timely and effective supervision and intervention. In line with international best practice, consideration should be given to providing explicit legal protection to DNB and the AFM, as well as their staff members, against lawsuits for actions taken in good faith while discharging their duties, provided they have not acted illegally.

CONDITIONS FOR EFFECTIVE INSURANCE SUPERVISION (ICP 1)

106. Insurance supervision in the Netherlands is facilitated by sound and progressive financial sector policy framework and financial market infrastructure. The Netherlands adopts international accounting and auditing standards. The deep and liquid financial markets in

Netherlands, as well as the easy access to international markets contribute to effective asset-liability management by insurers.

THE SUPERVISORY SYSTEM (ICP 2–ICP 5)

107. **DNB and the AFM have clear mandates for prudential and market conduct regulation and supervision, respectively.** Both supervisors are subject to clear accountability mechanisms under the Wft. Their supervisory staffs are competent and qualified. While the Wft provides adequate powers to DNB/AFM to supervise regulated entities within the legal parameters established by the MoF, there is scope for DNB and the AFM to be accorded broader legal authority. Considerations should be given to providing explicit legal protection to the authorities and their staff members, in line with international best practices. It is important that DNB is equipped with adequate supervisory resources for effective supervision, particularly in respect of internationally active insurance groups.

108. **DNB adopts a well-defined and transparent supervisory approach, supported by the FIRM Framework that helps to ensure consistency in supervisory assessment and decisions.** It has clear accountabilities to the Minister of Finance, the industry and the public through various channels.

109. **DNB and the AFM are empowered and do regularly exchange information with other supervisors, both within and beyond EU.** DNB is a signatory to the EU/EEA Protocols on Supervisory Cooperation and the IAIS Multilateral Memorandum of Understanding.

THE SUPERVISED ENTITIES (ICP 6–ICP 10)

110. **The licensing regime for insurers is clear, transparent and in line with EU Directives.** Under the current supervisory focus on integrity and culture, DNB performs robust due diligence on any proposed owner, controller or director prior to licensing and in approving the appointment and subsequent changes in key functionaries.

111. **DNB will only approve applications for qualifying shareholding and controllers if it is satisfied with the applicant's fitness and propriety, taking into account other supervisory considerations.** It may impose conditions or restrictions when granting such approvals, where appropriate. Portfolio transfers must be approved by DNB.

112. **Drawing from the lesson learned during the financial crisis in 2008/2009, DNB has strengthened the robustness of its assessment of insurers' corporate governance, not just in form but also in substance.** Its supervisory activities in 2009 and 2010 focused on insurers' business models and strategies as well as conduct and culture. The impending release of the Code of Conduct by the insurance industry and the DNB's framework for supervising culture and behavior of supervised entities will further enhance the effectiveness of insurers' corporate governance.

113. **DNB has articulated clearly its supervisory expectation of insurers in implementing appropriate internal controls tailored to the nature, scale and complexity of their operations.** It proactively monitors insurers' internal controls systems and has promoted greater awareness and buy-in from insurers.

ONGOING SUPERVISION (ICP 11–ICP17)

114. **DNB takes a proactive and transparent approach in market analysis to identify, assess and mitigate risks to the insurance sector.** It takes appropriate measures to strengthen insurers' resilience to systemic risks. The publication of comprehensive insurance and other market statistics also facilitate insurers' better understanding of their potential macro-economic risk exposures.

115. **DNB has a systematic process in reviewing regulatory returns and other information provided by insurers as part of its offsite surveillance.** The quarterly returns introduced informally in 2009 should form part of DNB's routine supervisory tools to ensure timely supervision and intervention. DNB conducts thematic inspections of insurers, which are prioritized, based on holistic analysis of insurers' risk profiles, to complement its regular meetings with insurers. It has conducted joint inspections with foreign supervisors to address specific supervisory issues.

116. **DNB is empowered to take a wide range of preventative measures and adopts an Intervention Ladder to calibrate its supervisory responses to emerging supervisory concerns.** It takes a proportionate approach in exercising enforcement and sanction powers under the Wft. The Wft provides for orderly exits of insurers and a high degree of protection for policyholders in the event of insolvency.

117. **The Netherland's regulatory frameworks for insurance groups and conglomerates are broadly in line with EU Directives.** As an integrated prudential supervisor, DNB has the capacity to effectively coordinate group/conglomerate supervision internally. The impending implementation of Solvency II will strengthen DNB's supervision of insurance groups, subject to the adequacy of supervisory resources.

PRUDENTIAL REQUIREMENTS (ICP 18–ICP 23)

118. **The Wft has established high-level requirements relating to insurers' risk management, supplemented by DNB's supervisory expectation under the Decree on Prudential Rules.** The effectiveness of insurers' risk management system is assessed by DNB as part of its FIRM framework. DNB monitors insurers' insurance risks through assessment of their risk management systems, technical provisions and solvency. DNB also reviews the adequacy of insurers' reinsurance programs and the collectability of reinsurance recoverables.

119. **There are clear legal principles and regulatory guidelines for insurers in estimating their insurance liabilities, the adequacy of which is to be supported by the Netherlands**

Liability Adequacy Test. DNB monitors insurers' technical provisions and has the power to require insurers to remedy any shortfall.

120. **Insurers are required to manage their investment risks in a manner proportionate to the nature, size, complexity and risk profile of their operations.** The regulatory policy and requirements for the use of derivatives by insurers are aligned with international best practice.

121. **The current solvency regime for insurers is largely based on Solvency I, with some enhancements.** Paving the way for the implementation of Solvency II, DNB has introduced the RiSK tool in 2009, through which insurers report their solvency position based on the Quantitative Impact Study of Solvency II. The implementation of Solvency II will result in a more robust and risk-sensitive solvency regime that will enhance DNB's risk-based supervision.

MARKETS AND CONSUMERS (ICP 24–ICP 27)

122. **The AFM administers the licensing of intermediaries with clear and transparent criteria.** The AFM actively monitors intermediaries' compliance with the regulatory requirements on professional conduct under the Wft and the Decree on the Supervision of the Conduct of Financial Enterprises pursuant to the Wft.

123. **The Wft requires insurer and intermediaries to ensure fair treatment of consumers including the provision of adequate information for informed decision.** However, the reputation of the life insurance industry had been tarnished by the sale of policies with excessive costs to policyholders. While the authorities have since strengthened supervision of intermediaries, there is scope for improving insurers' product development process. It will take time to strengthen consumer protection, which requires changes in culture, mindset and competency level of intermediaries.

124. **DNB and the AFM publish extensive market data and analysis, including key performance data of individual insurers.** Selected regulatory information is easily accessible by the public through their websites or public inspection of regulatory returns.

125. **DNB, as well as industry participants have taken a proactive approach to combating insurance fraud.** There is also close cooperation and information exchange with enforcement agencies and other supervisors, both locally and internationally, to address fraud to preserve the integrity of the insurance sector.

AML/CFT (ICP 28)

126. **The AML/CFT requirements applicable to insurers are broadly in line with the FATF recommendations although there is scope for updating the AML/CFT legislative framework in some areas.** DNB's inspections cover life insurers' compliance with their AML/CFT obligations.

Table 8. The Netherlands: Recommendations to Improve Observance of ICPs

Principle	Recommended Action
Principle 2 Supervisory objectives	The authorities are advised to consider articulating more clearly how their supervisory mandates apply to their respective roles in protecting policyholders.
Principle 3 Supervisory authority	The authorities are advised to consider: <ul style="list-style-type: none"> a) Broadening the legal authority of DNB and the AFM to enhance the effectiveness of their supervision; b) Providing explicit legal protection to DNB and the AFM, as well as their staff members, against lawsuits for actions taken in good faith while discharging their duties, provided they have not acted illegally; c) Publication of reason for removal of Board members; and d) Review the adequacy of supervisory resources particularly for effective supervision of internationally active insurance groups and implementation of Solvency II.
Principle 7 Suitability of Persons	As external auditors and actuaries contribute to the effectiveness of supervision, there is scope for DNB to consider strengthening collaboration with the professional associations with the objective of promoting more robust quality control over the work of the auditors and actuaries without compromising its duty to preserve confidentiality of official information.
Principle 12 Reporting to supervisors	DNB should be empowered to require insurers to submit quarterly returns as a routine supervisory practice, with appropriate powers for enforcement and sanctions.
Principle 17 Group-wide supervision	The authorities are advised to consider: <ul style="list-style-type: none"> a) removing the explicit legal restriction against DNB to impose qualitative and quantitative limits on intra-group transactions and balances under the Bptfg; b) reviewing the adequacy of supervisory resources, particularly for the effective supervision of international active groups/conglomerates; c) harmonizing the supervisory approach for insurance groups and conglomerates in the area of risk concentration and solvency requirements; and d) formulating appropriate regulatory requirements applicable to non-regulated holding companies, in line with Solvency II and international regulatory developments.
Principle 25 Consumer Protection	The authorities are advised to carefully consider the trade-offs between self-regulation and robust supervision to protect the interests of policyholders.
Principle 28 Anti-money-laundering, combating the financing of terrorism	The authorities are advised to update the legal provisions on record retention, appointment of anti-money laundering compliance officers and the requirements where insurers rely on intermediaries to perform customer due diligence, to bring these in line with FATF Recommendations.

AUTHORITIES' RESPONSE TO THE IAIS ASSESSMENT

The Dutch authorities want to express their appreciation to the IMF and the assessment team for their comprehensive work. The Financial Sector Assessment Program has been a useful exercise. The worldwide experience of the IMF and the use of a common methodology have delivered a useful insight in the current state of financial regulation and supervisory practice in the Netherlands.

The authorities welcome the overall assessment that indicates a high level of observance of insurance supervision with the well respected IAIS Insurance Core Principles. Notwithstanding this good result, the developments in the financial sector and the experience from the global financial crisis continue to call for vigilant action. The recommendations of the IMF are therefore well received and will be considered carefully by the authorities in their continuous efforts for strengthening supervision.

With regard to the recommendations, several initiatives have already been taken up since the conclusion of the FSAP mission.

As the assessment rightfully notes, most recommendations will be addressed with the upcoming implementation of the European Solvency II framework. Capital adequacy standards will be more robust and risk-sensitive under the new framework. Also, the quarterly returns that are now received from the institutions on an informal basis, will then be formally required. In addition, Solvency II will strengthen DNB's ability for group-wide supervision, including more stringent rules on intragroup transactions. The introduction of Solvency II will thus bring supervisory practice even further in line with the IAIS core principles.

Effective supervision of international active groups will remain a priority and DNB actively seeks cooperation with international supervisors both bilaterally and through colleges of supervisors. In addition, the scope of supervision with regard to holding companies will be strengthened under Solvency II and the review of the financial conglomerates directive. DNB will increase its supervisory resources to intensify its supervision and already started to do so in recent months, although its approach will remain risk-based and priorities will need to be made.

The Minister has recently announced proposals with regard to the institutional framework and the division of responsibilities between the Ministry of Finance and the supervisors. Also, the Ministry of Finance and the Ministry of Justice are exploring the possibilities to limit the liability of the financial supervisors by explicitly laying down the limitation in legislation.

The report rightfully acknowledges that the insurance sector is currently under pressure, because of adverse market conditions and its damaged reputation. Most of all, it is the responsibility of the sector itself to renew its business model and restore its reputation. Several initiatives have already been taken by the sector and the association of insurers. The AFM with its mandate for conduct of business supervision, is responsible for due care in the provision of services to clients and adequate consumer protection. In this context, it is noted that the supervision of intermediaries has been strengthened. The AFM is currently discussing with the Ministry of Finance whether its mandate in this respect should be strengthened.