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## **The financial crisis 2008-2009**

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# 1 INTRODUCTION

Concurrently with our regularity audit for 2008, we examined the main interventions and arrangements made by the Ministry of Finance in response to the financial crisis. The audit covered the last four months of 2008 and the first quarter of 2009.

We examined the following interventions and arrangements:

- the state's acquisition of a shareholding in Fortis/ABN AMRO;
- the capital injection facility (for ING, AEGON and SNS REAAL);
- the bank loan guarantee facility;
- the extension of the bank deposit guarantee scheme;
- the prefunding of payments under the bank deposit guarantee scheme in relation to Iceland;
- the back-up facility for ING.

This report lists the main characteristics of each intervention or arrangement, together with the relevant terms and conditions, the checks and controls that were put in place to secure compliance with these terms and conditions and, finally, the Court's powers. This report will also provide the input for a web file to be opened on the Court's website on the date on which it is published. The web file will also contain other relevant information, such as on the activities undertaken by our counterparts in other countries in response to the financial crisis.



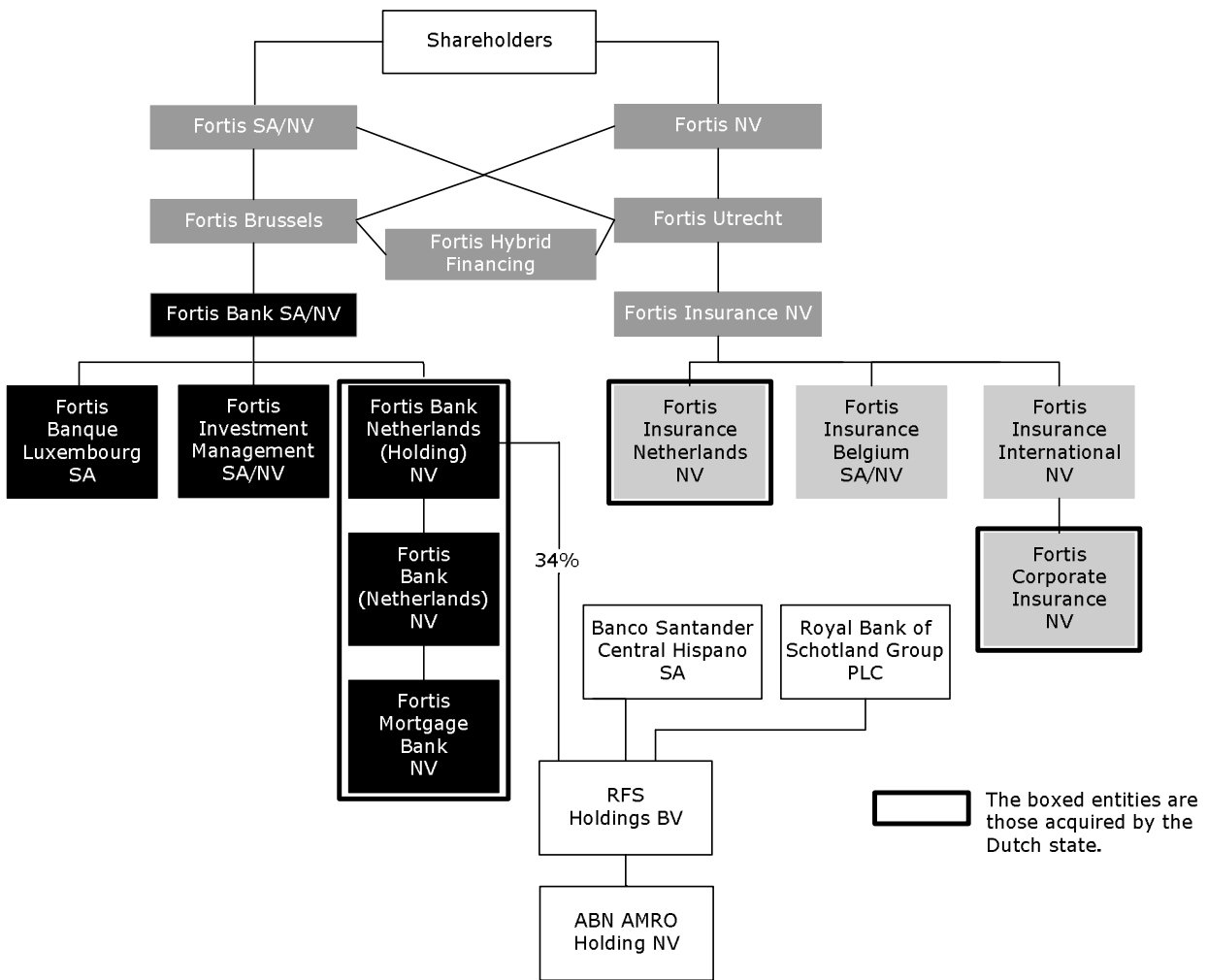
## 2 INVESTMENT IN FORTIS/ABN AMRO

<b>Nature of intervention:</b>	Acquisition of interest in and granting of loans to Fortis/ABN AMRO and RFS Holding
<b>Date:</b>	3 October 2008
<b>Amount involved (acquisition of shares):</b>	€16.8 billion (interest in Fortis/ABN AMRO) and €6.54 billion (RFS Holding)

### 2.1 Investment in Fortis

#### 2.1.1 Acquisition of Fortis shares

On 3 October 2008, the state acquired a 92.6% interest in Fortis Bank Nederland Holding (FBNH), a 100% interest in Fortis Insurance Netherlands NV (FVN), a 100% interest in Fortis Corporate Insurance NV (FCI) and a 70% interest in Fortis FBN(H) Preferred Investments BV. These are shown in the following figure (in which the names of the entities have been translated for the sake of convenience).



The boxed entities are those acquired by the Dutch state.

The above figure does not include the interest acquired by the state in Fortis FBN(H) Preferred Investments BV. The latter investment resulted in the state acquiring a further 5.2% in FBNH, thus bringing the total shareholding to 97.8%. In aggregate, the state paid Fortis Bank SA/NV €16.8 billion for these shares.



### **2.1.2 Acceptance of liability for Fortis' debts**

The Dutch state immediately repaid the €34 billion worth of short-term loans granted by Fortis Bank SA/NV to Fortis Bank Nederland (FBN), and also accepted liability for €16.075 billion worth of long-term loans. Although the Dutch state has funded the bulk of these loans to date, the idea is for FBN eventually to fund these loans itself on the financial markets. In the meantime, some of this long-term debt has already been wiped out as a result of the state's acquisition of RFS Holdings BV for €6.54 billion. The total value of the outstanding debt as at the end of 2008 was €44.3 billion.

### **2.1.3 Acquisition of RFS<sup>1</sup> Holdings BV/ABN AMRO**

In December 2008, the Dutch state acquired a 33.8% interest in RFS Holdings BV from FBNH. RFS Holdings BV was the name of the company formed by the takeover consortium of Royal Bank of Scotland (RBS), Fortis and Banco Santander for the purpose of holding the shares in ABN AMRO following the latter's acquisition by the consortium. The idea was to use RFS Holdings BV as a channel through which to distribute ABN AMRO's assets among the three consortium banks. In exchange for the Dutch state's acquisition of RFS Holdings BV, the equivalent value in long-term debt owed by FBNH was redeemed. This value was set at €6.54 billion.

## **2.2 Contract terms**

The state's investment in Fortis/ABN AMRO is subject to a number of conditions, which we have summarised in the following sections. A number of these conditions are financial, whilst others relate to the issue of governance. On 21 November 2008, the Minister of Finance set out his views on the new state-owned shareholdings.<sup>2</sup> He made it clear that he intended to convert FBN and ABN AMRO from two separate entities into a single bank.

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<sup>1</sup> The abbreviation RFS stands for RBS Fortis Santander.

<sup>2</sup> House of Representatives, 2008-2009 session, 31 789, no. 1.





### **2.2.1 Private-market funding of loans acquired by the state**

Prior to the takeover, FBN had obtained all its funding from Fortis Bank Belgium, which also acted as a treasurer to Fortis Holding. When the Dutch arm was separated from the rest of the group, it no longer had access to a fully operational treasury. By an unfortunate coincidence, ABN AMRO's treasury was one of the activities sold to RBS as part of the deal with the latter, which meant that FBN was unable to make use of its services. Due to the absence of a proper treasury, the Dutch State Treasury Agency is currently acting as the bank's treasurer and will do so until the latter is able to perform this role itself. The Agency has not signed a formal written treasury contract with FBN.

The Agency has only a limited role to play as a treasurer to Fortis Bank Nederland (FBN). A figure of €40 billion has been set as the ceiling for the long-term credit facility granted to FBN by the Dutch state, with a further ceiling of €5 billion for day-to-day fluctuations. This overnight facility, as it is called, has not been in constant use and the Agency has reached an agreement with FBN that the credit lines will gradually be phased out by the end of 2009. This means that FBN will have to obtain more and more of its funding on the money and capital markets. The Agency uses the rate of interest it charges FBN as an incentive to encourage the latter to obtain its funding from other sources.

Initially, the Dutch State Treasury Agency was in daily contact with both FBNH and the Dutch central bank, in order to preclude any threats to the bank's liquidity position. This also enabled the Agency to ensure that FBNH did not borrow too heavily from the state. It should be stressed that the credit ceiling has not been exceeded on any occasion. The €5 billion overnight borrowing facility was terminated on 1 March and meetings are now held on a weekly rather than on a daily basis. One of the reasons why the Agency gradually needs to cease acting as a treasurer to Fortis is to reduce the number of roles performed by the Ministry in relation to Fortis.

### **2.2.2 Capital requirement of Fortis Bank Nederland (FBN)**

In order to obtain cash, FBN sold a parcel of securitised mortgage loans to the European Central Bank (ECB). On 24 March 2009, FBN also applied to the state for permission to join the bank loan guarantee scheme, for a sum of €5 billion.



### **2.2.3 Assistance from Dutch central bank**

Early on in the proceedings, the Dutch central bank supplied FBN with a bridging loan so as to enable the Ministry of Finance to raise the necessary cash on the financial markets. This bridging loan was repaid in its entirety within the space of one month.

### **2.2.4 No misuse of corporation tax exemption**

The state intends to ensure that the investment in Fortis/ABN AMRO does not unintentionally result in the bank enjoying an exemption from corporation tax. If necessary, the law will be amended retroactively in order to prevent this from happening. This is stated in a letter from the government to the House of Representatives on the subject of the state investment in Fortis.<sup>3</sup> There are no indications that any misuse has been made of corporation tax exemptions.

### **2.2.5 Sale of various parts of ABN AMRO as part of the 'remedy' agreed with the European Commission**

The state's acquisition of Fortis/ABN AMRO has prompted a review of the proposed sale of various parts of ABN AMRO with a view to obtaining the approval of the European Commission.

### **2.2.6 Mitigating any unfair competitive advantage**

Following its investment in Fortis/ABN AMRO, the state is planning to take action to prevent the bank from enjoying any unfair advantages over its competitors. This point is also raised in the government's letter to the House of Representatives on the subject of the investment in Fortis.<sup>4</sup>

### **2.2.7 Governance and remuneration policy**

The government has made clear that the state intends to exercise a measure of control over the bank's management and supervisory boards, for example in relation to the remuneration policy. Although existing private-law contracts on remuneration will be respected, the state does intend to have a say in future remuneration policy. At the time when the investment was made, no details were given of how this was to be achieved. The Minister did give various details later on, in November

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<sup>3</sup> House of Representatives, 2008-2009 session, 31 371, no. 12.

<sup>4</sup> House of Representatives, 2008-2009 session, 31 371, no. 12.



2008, when he set out his views on the investment. One of the items mentioned by the Minister is the severance arrangement, under which the maximum amount payable will be one year's salary. This is the same condition as applies to the capital injection and bank loan guarantee.

### **2.3 Assessing compliance with the contract terms**

Various departments of the Ministry of Finance have some say and control over the investments. These include the Financing Department and the Dutch State Treasury Agency. The Ministry's organisational structure is due to be adjusted in 2009 so that it can deal better with the new situation, in which the state owns shareholding in a number of large financial institutions.

As a shareholder, the state is also able to influence the composition of the management and supervisory boards and thus ensure that the bank is acting both in accordance with the terms and conditions of the shareholding and in the public interest.

Naturally, the Dutch parts of Fortis and ABN AMRO are also subject to the general supervision of the Dutch central bank and the Netherlands Authority for the Financial Markets.

The European Commission is looking into the takeover of Fortis/ABN AMRO so as to ensure that it does not constitute a form of unauthorised state aid. At the beginning of December 2008, the Commission decided that the takeover of Fortis Insurance Netherlands was not tantamount to the provision of state aid. On 8 April 2009, the Commission announced that it would be launching a wide-ranging investigation to ascertain whether the government action taken in relation to Fortis Bank Nederland (FBN) and those parts of ABN AMRO that were acquired by Fortis complied with EU rules on state aid.

### **2.4 Powers of the Netherlands Court of Audit**

Under Article 87 of the Government Accounts Act 2001, the Netherlands Court of Audit is entitled to audit any central government department or unit, if it believes that it needs to do so in order to discharge its duties. This means that, as far as the investment in Fortis/ABN AMRO is concerned, the Court is entitled to perform an audit at the Ministry of Finance.



Article 91 (1a) of the Government Accounts Act 2001 grants the Court certain powers in relation to both public and private limited companies of which the state directly owns either all or virtually all the issued share capital. This applies to the 100% shareholdings in Fortis Insurance Netherlands NV and Fortis Corporate Insurance NV. The state has a 97.8% shareholding in Fortis Bank Nederland Holding NV. The phrase 'virtually all the issued share capital' as used in Article 91 of the Government Accounts Act 2001 was originally intended to apply to a situation in which the state, as a result of circumstances beyond its control, was unable to acquire a small number of outstanding shares. It is not clear whether the legislative history also applies to the present situation. For the time being, the Court is assuming that a figure of 97.8% is tantamount to 'virtually all the issued share capital'. This means that Fortis Bank Nederland Holding NV falls under the powers granted to the Court under Article 91 (1a) of the Government Accounts Act 2001.

Article 91 (1b) of the Government Accounts Act 2001 grants the Court limited powers in relation to public and private limited companies of which the state directly owns at least 5% of the issued share capital. The Court is not empowered to audit the latter companies on their premises.

The Netherlands Authority for the Financial Markets is responsible for supervising the banking and insurance markets, whilst the Dutch central bank is responsible for the prudential supervision of the financial institutions and for supervising the stability of the financial system. Article 91 of the Government Accounts Act 2001 grants the Court certain powers with regard to both the Netherlands Authority for the Financial Markets and the Dutch central bank as financial regulators. The duties of the Dutch central bank in relation to the enforcement of the Treaty establishing the European Community are covered by the Court's general powers as set out in Article 87 (1) of the Government Accounts Act 2001, rather than by the specific powers granted under Article 91 (see paragraphs 3 and 4). Incidentally, the Explanatory Memorandum to the Government Accounts Act 2001 states that the Court is not entitled to have access to information held by the Dutch central bank on individual persons or companies.



### 3 CAPITAL INJECTION FACILITY

<b>Nature of intervention:</b>	Capital injection facility
<b>Date:</b>	<p>ING: 20 October 2008 (House of Representatives, 2008-2009 session, 31 371, no. 23)</p> <p>AEGON: 29 October 2008 (House of Representatives, 2008-2009 session, 31 371, no. 32)</p> <p>SNS REAAL: 14 November 2008 (House of Representatives, 2008-2009 session, 31 371, no. 48)</p>
<b>Amounts involved (securities):</b>	<p>ING: €10 billion</p> <p>AEGON: €3 billion</p> <p>SNS REAAL: €750 million</p>

#### 3.1 Nature of the facility

On 10 October 2008, the Minister of Finance announced that the Dutch government had pledged to inject capital in banks and insurance companies which, despite being fundamentally sound and viable institutions, were unable, because of the financial crisis, to comply in any other way with the solvency requirements set by the regulatory authorities, i.e. the Dutch central bank. Under these requirements, financial institutions are required to retain a given amount of capital as a buffer to offset any decline in the value of their assets.<sup>5</sup> The Minister initially set aside €20 billion for this facility.

Three banks and insurance companies, viz. ING, AEGON and SNS REAAL, made use of this facility during the final quarter of 2008. The aggregate amount of capital injected into these three companies was €13.75 billion. Although it is clear from the relevant parliamentary papers that the institutions in question did not actually need the capital injection (yet) in order to satisfy the central bank's solvency requirements, the state

<sup>5</sup> House of Representatives, 2008-2009 session, 31 371, no. 18.



nonetheless decided to make the capital injections in these three cases. This was because the Ministry of Finance had come to the conclusion, in consultation with the Dutch central bank, that the present market circumstances were such that these companies' capital position needed to be strengthened. In other words, the need to satisfy the central bank's solvency requirements was not a strict criterion for the granting of the facility.

On 5 February 2009, in response to a request from the House of Representatives, the Minister of Finance restated the conditions applying to the capital injection facility.<sup>6</sup> The Minister again made clear, as he had done in his first letter of 10 October 2008 on the same subject, that the facility was intended for financial institutions wishing to raise their capital to levels deemed to be adequate by the supervisory authorities.

The government selected the instrument of special securities<sup>7</sup> as the best means of strengthening the institutions' capital, as these gave the institutions immediate access to the capital. This was seen as being a better option than the issue of ordinary shares, which would first require the consent of the general meeting of shareholders, a step that would create delays and uncertainty. As no shares were issued, there was no need to follow the 'preliminary scrutiny procedure' required under Article 34 of the Government Accounts Act 2001.

The Dutch central bank regards the special securities as forming part of the institutions' equity capital. Strictly speaking, therefore, the capital injection has resulted in an increase in their net asset value per share (i.e. as long as the bonds are not converted). In the event of the institutions undergoing compulsory liquidation, the securities enjoy the same status as that of ordinary shares.

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<sup>6</sup> House of Representatives, 2008-2009 session, 31 789, no. 3.

<sup>7</sup> The 'special securities' used in this particular instance were convertible subordinated bonds. Like shares, these bonds are divided into individual units.



## 3.2 Contract terms

### 3.2.1 General

The contracts with the three financial institutions which have benefited from the capital injection facility are broadly similar. The main terms relate to the following aspects:

- The value of the investment, and the price per unit.
- The annual coupon paid in return for the capital injection. This is either a fixed sum per unit or a percentage of the dividend paid, if the latter is higher. If no dividend is paid, no coupon is paid either.
- The share of any interim dividend paid in 2008.
- The methods of terminating the investment. The idea here is to make it gradually more and more attractive for a financial institution to terminate the state's investment.
- The possibility of converting the bonds into ordinary shares after three years have elapsed. Provided that the regulatory authority agrees, the state may opt for a cash payment in lieu of conversion (at 100% of the securities' issue price).
- The recipient of the capital pays the transaction costs incurred (both by the institution in question and by the state) in issuing the securities.
- The government-nominated supervisory directors (of whom there are two at each institution) are required to approve all fundamental decisions, such as decisions on mergers and takeovers involving over 25% of the institution's equity capital, and also to approve all proposals presented to shareholders on the institution's remuneration policy.
- The government-nominated supervisory directors are members of various important committees operating under the aegis of the supervisory board, i.e. the audit committee, the remuneration and nomination committee and (in the case of ING) the corporate governance committee.
- The institution should commit itself to a sustainable remuneration policy for members of the management board and senior managers.
- The members of the institutions' management boards should waive their bonuses for 2008. The severance pay awardable to members of the management board should be limited to one year's fixed salary (in accordance with the Dutch Corporate Governance Code).



- The capital injection should not have any effect on the institutions' competitive position. In the case of AEGON and SNS REAAL, it has been explicitly agreed in this connection that the capital injection may not be used for improper, i.e. promotional, purposes.

The detailed terms applying to each financial institution are set out in the following sections.

### **3.2.2 ING**

The specific terms and conditions agreed for ING are as follows.

- The value of the investment is €10 billion, consisting of one billion units purchased at a price of €10 per unit.
- The annual coupon payable per unit may not exceed €0.85 (or 8.5%) or 110% of the value of the 2009 dividend, 120% of the value of the 2010 dividend and 125% of the value of the dividend paid as from 2011.
- The state will receive a payment of €425 million on 12 May 2009, to account for the interim dividend paid in 2008.
- The investment may be terminated by ING buying-out the units at a price of €15 per unit (i.e. 150% of the issue price). The consent of the Dutch central bank is required for termination in this manner.
- The coupon is not payable (but remains due) if the Dutch central bank takes the view that this is precluded by ING's financial situation. The coupon will become payable as soon as the Dutch central bank feels that it is safe to pay.
- If ING fails to meet its payment obligations to the state, the only remedy available to the state is to petition for its compulsory liquidation. In other words, the state is not able to act like an individual creditor and apply for a court ruling ordering ING to comply with its financial obligations.

### **3.2.3 AEGON**

The specific terms and conditions agreed in relation to AEGON are as follows.

- The AEGON Association receives a loan from the state, which the Association uses to purchase securities in the form of convertible subordinated bonds issued by AEGON NV.
- The investment consists of €3 billion worth of securities, comprising 750 million units at a price of €4 per unit.
- The AEGON Association grants the state a pledge on the securities and all the Association's assets, i.e. the shares in AEGON NV and other





securities. Insofar as these had already been pledged (as applies to all the shares in AEGON NV), the state's right of pledge takes effect only if the previous right of pledge lapses.

- The annual coupon payable per unit may not exceed €0.34 (or 8.5%) or 110% of the value of the 2009 dividend, 120% of the value of the 2010 dividend and 125% of the value of the dividend paid as from 2011.
- The state will receive a payment of around €124 million in the spring of 2009, to account for the interim dividend paid in 2008.
- The investment may be terminated by AEGON buying-out the units at a price of €6 per unit (i.e. 150% of the issue price). The consent of the Dutch central bank is required for termination in this manner.
- The first €1 billion may be repaid in cash during the first year, provided that certain special conditions are met. In this event, AEGON is obliged to pay the coupon, even if the dividend is lower. Depending on the share price, AEGON may be required to make an additional payment. If the shares are priced at €4 or less, AEGON will not be required to make an additional payment. If the shares are priced at €5 or more, AEGON will be required to make an additional payment the amount of which may not exceed €130 million (13%). If the shares are priced at between €4 and €5, AEGON will be required to make an additional payment of between €0 and €130 million for the relevant part of the first year, to be calculated on a *pro rata* basis.
- Under the arrangements made with AEGON, six-monthly review meetings are to be held. Prior to these meetings, AEGON will present the state with its views on whether the arrangement needs to be adjusted within the coming five years.

### **3.2.4 SNS REAAL**

The specific terms and conditions agreed in relation to SNS REAAL are as follows.

- The investment consists of €750 million worth of securities, at an issue price of €5.25 per unit.
- The annual coupon payable per unit may not exceed 8.5% or 110% of the value of the 2009 dividend, 120% of the value of the 2010 dividend and 125% of the value of the dividend paid as from 2011.
- The state will receive a payment of around €31 million on 30 May 2009, to account for the interim dividend paid in 2008.
- The investment may be terminated by SNS REAAL buying-out the units at a price of €7.875 per unit (i.e. 150% of the issue price). The consent of the Dutch central bank is required for termination in this manner.



- The first €250 million may be repaid in cash during the first year, provided that certain special conditions are met. In this event, SNS REAAL is obliged to pay the 8.5% coupon for the relevant part of the first year. Depending on the share price, SNS REAAL may be required to make an additional payment. If the shares are priced at less than the issue price, SNS REAAL will not be required to make an additional payment. If the shares are priced at €6.56 or more, SNS REAAL will be required to make an additional payment the amount of which may not exceed €32.5 million (13%). If the shares are priced at between the issue price and €6.56, SNS REAAL will be required to make an additional payment of between €0 and €32.5 million for the relevant part of the first year, to be calculated on a *pro rata* basis.

### **3.3 Assessing compliance with the terms and conditions**

Various instruments may be used for ensuring that the institutions comply with the agreed terms and conditions. These are discussed in detail in the following sections.

#### **3.3.1 Approval of Dutch central bank**

Under the terms of the contracts with the financial institutions, the prior written consent of the Dutch central bank is required for a number of transactions, including:

- the physical transfer of the securities to the state;
- capital injections of over €300,000 in non-EU-based subsidiaries;
- a judgement by the Dutch central bank as to whether the financial institution's situation is such as to warrant the payment of a coupon (as well as a dividend, where relevant);
- approval of the calculation of the stock securities for the state, where a stock dividend is paid to shareholders;
- resale, conversion or optional buy-out;
- the issue of a certificate by the Dutch central bank confirming that it does not have any objections to the nomination by the supervisory board of a prospective member of the board.

#### **3.3.2 Approval of government-nominated supervisory directors**

Under the terms of the contracts with the financial institutions, the approval of all the government-nominated supervisory directors is required for certain management board resolutions and proposals, including those involving:



- the listing or delisting of shares or depositary receipts on a stock exchange;
- the commencement or termination of partnerships of major material significance;
- the acquisition of a new interest or a rise in the value of an existing interest representing at least 25% of the value of the institution's equity capital;
- the investment of at least 25% of the value of the institution's equity capital;
- the filing of a petition for compulsory liquidation or for a suspension of payments;
- a reduction in the institution's capital;
- plans for a merger, separation or winding-up;
- proposals to be made to the General Meeting of Shareholders to alter the remuneration policy.

### **3.3.3 Other provisions relating to government-nominated supervisory directors**

The contracts also contain provisions on the sharing of information with the state. These are based on the principle that banks and insurance companies should be able to operate without any direct government intervention. However, in certain exceptional circumstances, a government-nominated supervisory director may be justified in informing the state about certain issues he or she believes to be important. A government-nominated supervisory director may, within the limits of the contract with the institution in question, share certain information with the state so that the latter is able to supervise the remuneration policy and monitor any substantial investments and/or purchases, and thus take steps to safeguard the state's investment.

The contracts contain more detailed provisions on this aspect, including certain guarantees relating to confidentiality and secrecy.

### **3.3.4 Assessment by the European Commission**

The European Commission assessed the capital injections made in ING, AEGON and SNS REAAL in order to ascertain whether they comply with the rules on state aid. The Commission found that the capital injections were compatible with the common market<sup>8</sup> and for this reason decided not to object to them. The Commission approved the measures as

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<sup>8</sup> Article 87m (3b) of the EC Treaty.



emergency aid for a period of six months provided in response to the financial crisis.

### **3.4 Powers of the Netherlands Court of Audit**

Under Article 87 of the Government Accounts Act 2001, the Netherlands Court of Audit is entitled to audit any central government department or unit, if it believes that it needs to do so in order to discharge its duties. This means that, as far as the capital injections are concerned, the Court is entitled to perform an audit at the Ministry of Finance.

Article 91 of the Government Accounts Act 2001 grants the Court certain limited powers in relation to both public and private limited companies of which the state owns at least 5% of the issued share capital. Due to the exceptional nature of the investment (i.e. involving securities rather than ordinary shares), the capital injections made in ING, AEGON and SNS REAAL are not tantamount to the acquisition by the state of shareholdings in these companies. Insofar as the investment may be regarded as constituting a subordinated loan, the Court has no powers under Article 91 of the Government Accounts Act 2001. This is the implication of the contents of paragraph 16 of Article 91, which expressly excludes financial undertakings from its audit powers.

The Netherlands Authority for the Financial Markets is responsible for supervising the banking and insurance markets, whilst the Dutch central bank is responsible for the prudential supervision of the financial institutions and for supervising the stability of the financial system. Article 91 of the Government Accounts Act 2001 grants the Court certain powers with regard to both the Netherlands Authority for the Financial Markets and the Dutch central bank as financial regulators. The duties of the Dutch central bank in relation to the enforcement of the Treaty establishing the European Community are covered by the Court's general powers as set out in Article 87 (1) of the Government Accounts Act 2001, rather than by the specific powers granted under Article 91 (see paragraphs 3 and 4). Incidentally, the Explanatory Memorandum to the Government Accounts Act 2001 states that the Court is not entitled to have access to information held by the Dutch central bank on individual persons or companies.



## 4 BANK LOAN GUARANTEE FACILITY

<b>Nature of intervention:</b>	Bank loan guarantee facility
<b>Date:</b>	23 October 2008
<b>Amount involved:</b>	Maximum value of guarantee: €200 billion

### 4.1 Explanation of guarantee facility

On 23 October 2008, the state created a guarantee facility worth a total of €200 billion for bank loans. The following table shows the guarantees issued in pursuance of the scheme during the period up to the end of March 2009.

**Table 1 Guarantees issued during period to end of March 2009**

<b>Bank</b>	<b>Date of issue of guarantee</b>	<b>Value of guarantee *</b>	<b>Term and rate of interest</b>	<b>Amount spent*</b>	<b>Percentage utilised</b>
Lease Plan Corp. NV	9 December 2008	1.60	Two-year fixed interest	1.45	91
NIBC Bank NV	27 November 2008	1.60	Three-year fixed interest	1.25	78
NIBC Bank NV	17 December 2008	0.04	One-year fixed interest	0.04	100
NIBC Bank NV	24 December 2008	0.10	Three-year fixed interest	0.10	100
SNS Bank NV	19 January 2009	2.00	Three-year fixed interest	2.00	100
Lease Plan Corp. NV	23 January 2009	1.50	Three-year fixed interest	1.25	83
ING Bank NV	30 January 2009	5.00	Three-year fixed interest	5.00	100
ING Bank	30 January	1.00	Three-year floating	1.00	100



NV	2009		interest		
NIBC Bank NV	9 February 2009	1.50	Three-year fixed interest	1.50	100
NIBC Bank NV	18 February 2009	0.50	Three-year floating interest	**	Unknown
ING Bank NV	19 February 2009	5.00	Five-year / eighteen- month fixed/floating interest	4.50	90
SNS Bank NV	5 March 2009	1.60	Five-year fixed interest	1.60	100
ING Bank NV	10 March 2009	3.00	Five-year / eighteen- month fixed/floating interest	2.40	80
NIBC Bank NV	30 March 2009	1.50	Five-year fixed interest		
<b>Total:</b>		<b>25.94</b>		<b>22.09</b>	

\*Amounts in €bn.

\*\*Details not yet known.

Between the date on which the scheme took effect and the closing date of our audit (i.e. 31 March 2009), guarantees worth a total of €25.94 billion were issued. Of this figure, €3.34 billion relates to guarantees issued in 2008. Until the end of March 2009, a total of €22.09 billion was spent on loans covered by these guarantees (of which €2.74 billion was spent in 2008). One further guarantee is not included in the table: on 6 April 2009, the state issued a €5 billion three-year guarantee to Fortis Bank Nederland.

The Dutch State Treasury Agency is responsible for operating the scheme. During the hectic period when the scheme was launched in response to the credit crisis, the Treasury General operated largely on an ad-hoc basis. The Dutch State Treasury Agency initially worked with an oral authorisation from the Minister of Finance. The Minister formally confirmed this authorisation on 18 March 2009.<sup>9</sup>

<sup>9</sup> This decision is based on Article 32 (4) of the Government Accounts Act 2001 in conjunction with Article 1 (3) of the Decree on Private-Law Legal Acts.



The guarantee scheme has been amended four times since it was first announced: on 11 November, 21 November and 27 November 2008 and again on 18 February 2009. The alterations made in November 2008 were the results of consultations with the banks, who raised a number of legal aspects in relation to which improvements were needed. Both the terms of the schemes, and a list of companies to whom guarantees have been issued, have been posted on the website of the Dutch State Treasury Agency.

The closing date for guarantee applications is 31 December 2009.<sup>10</sup> The European Commission has authorised the first version of the guarantee scheme for the period until 30 June 2009. The Commission may insist on certain supplementary terms and conditions being added to the terms of the scheme before granting an extension of its approval.

## 4.2 Contract terms

The Minister informed the House of Representatives of the basic contents of the scheme when it was announced.<sup>11</sup>

- The guarantee applies only to senior unsecured loans, non-subordinated loans made to banks without any collateral requirements, with a minimum term of three months and a maximum terms of 36 months<sup>12</sup> (limited to commercial paper, certificates of deposit and medium-term notes).<sup>13</sup>
- Only banks in possession of a Dutch banking licence and with 'substantial' business activities in the Netherlands are eligible for a guarantee.
- The applicant should be sufficiently solvent on an ongoing basis (to the satisfaction of the Dutch central bank).
- The loan must be commensurate with the applicant's liquidity position (to the satisfaction of the Dutch central bank).
- Conditions may be set regarding the composition of the applicant's balance sheet.
- The applicant has to meet certain corporate governance requirements in relation to bonuses and severance schemes.

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<sup>10</sup> Letter of 25 November 2008 from the Minister of Finance to the House of Representatives (AGT/2008/1174M).

<sup>11</sup> Letter of 25 November 2008 from the Minister of Finance to the House of Representatives (AGT/2008/1174M).

<sup>12</sup> Later extended to a maximum of 60 months.

<sup>13</sup> As set out in a letter of 21 October 2008 from the Minister of Finance to the House of Representatives (ref. AGT/2008/1059).



- Where a guarantee is issued to a bank, this must be used to back a loan.

The following sections describe the terms included in the latest version of the scheme, i.e. the version published on 18 February 2009. We have highlighted the main changes relative to and between previous versions of the scheme.

The scheme lists the various requirements a bank must meet in order to qualify for a guarantee. In the first place, the bank must fall under the scope of the definition given in the Financial Supervision Act. Second, it must have its registered office in the Netherlands. Third, it must undertake 'substantial' business activities in the Netherlands. And fourth, it must comply with the solvency requirement.

The Agency is entitled to permit other forms of simple loans in addition to those originally listed by the Minister. The situation today is that permitted loans also include a package of multiple simple loans, provided that this falls under the bank's refinancing strategy. In the new version of the scheme, the maximum term has been extended from three to five years. Under the terms of the scheme, the size and term of the loan must comply with certain criteria. In order for the guarantee to retain its validity, the loan must be granted within a period of either 30 days or three months, depending on the type of loan involved. The Agency is entitled to depart from certain aspects of the guarantee criteria.

Under the terms of the guarantee scheme, the applicant must include in its application a statement under which both itself and the group to which it belongs make certain commitments in the following areas, among others:

- legal status and powers;
- the company's powers in the framework of the implementation of the guarantee scheme;
- the requirements relating to the compilation and publication of financial reports;
- a commitment to act in accordance with the publication rules, the law and the regulations laid down by the Dutch central bank and the Netherlands Authority for the Financial Markets;
- an assurance that the company is not involved in any court proceedings or administrative procedures entailing certain risks for the company, and that the Dutch central bank does not have any objections.





The applicant is also required to state that both it and the group to which it belongs comply with requirements relating to:

- the provision of relevant information to the state, both in the event of it not being able to discharge its obligations under the loan contract or contracts and also in terms of supplying financial information to the state;
- the soundness of its operational management, its ability to maintain its solvency ratio at an adequate level, and a possible merger with another company;
- remuneration and dismissal arrangements, including the pursuit of (or plans to pursue) a sustainable remuneration policy for the directors and senior managers, the limitation of (or plans to place limits on) the severance pay awarded to member of the management board to one year's fixed salary, and compliance (or plans to comply) with Section II:2 of the Dutch Corporate Governance Code on remuneration (the latter two requirements were not included in the first version of the scheme).
- European law.

Where a bank makes use of a guarantee, it is required to pay a fee as defined in the scheme. This fee is equivalent to the credit default swap spread<sup>14</sup> for the bank in question, plus 50 basis points for loans with a term of more than one year. The fee for short-term loans is 50 basis points.

The bank is also required to pay a fine if the guarantee is not actually utilised for at least 75% of its value, either within 30 days of the issue date in the case of guarantees issued for unpackaged (i.e. simple) loans or within 60 days of the issue date in the case of guarantees for package loans. The fine is calculated on the difference between the value of the guarantee and the amount actually spent, and is based on the rate for short-term loans (i.e. 50 basis points).

There is a further condition that the fee should be paid on the coupon date (under the old versions of the scheme, the fee was payable at the start of the year). Finally, the new version of the scheme may not affect any guarantees already in operation.

The Agency is entitled to issue a guarantee even if not all of the conditions have been satisfied. The Agency is also entitled to accept a proposal submitted by a bank for altering the wording of the statements it

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<sup>14</sup> This is a fee for credit risk, the size of which is contingent on the borrower's risk profile.



is required to make about its compliance with the terms of the scheme. Finally, the Agency is entitled to set further criteria. During the period covered by the audit, i.e. up to 31 March 2009, the Agency did not exercise its right to deviate from the terms of the guarantee scheme in individual cases.

## **4.3 Assessing compliance**

### **4.3.1 Organisation**

The Agency is divided into the following organisational units:

- policy-making;
- front office (i.e. commissioning and settlement);
- back office (i.e. accounts and administrative control).

The Agency initially assumed that the guarantee scheme would only involve a certain amount of operational activities, and for this reason decided to make the back office responsible for handling the scheme. It is now clear, however, that a certain amount of policy planning is also required and that the management side of the scheme is more time-consuming than anticipated. For this reason, it has been decided that the guarantee scheme will soon be made subject to the same procedures as already apply to the Agency's financing activities, i.e. it will form part of the Agency's standard work flow, starting with policy-making and then passing from the front office to the back office.

### **4.3.2 Procedure for assessing compliance with guarantee terms**

Both an assessment procedure and accounting guidelines have now been formulated, although these still need to be formally adopted. The procedure for assessing guarantee applications includes a two-step review: the first step is designed to ensure that the applicant meets the terms of the guarantee scheme and the second is aimed at ascertaining whether the person representing the applicant has the appropriate powers of representation. The procedure also involves asking the Dutch central bank for its opinion.

The first part of the review, i.e. assessing whether the applicant meets the terms of the guarantee scheme, is performed by two separate members of staff. A control function has been set up at the back office to ensure that the appropriate checks are performed before a guarantee is



issued, for checking that the loan is granted in good time and for calculating the fees and any fines that may be due.

No guidelines have been formulated as yet for checking compliance with the guarantee terms during the actual period covered by the guarantee. A proper supervisory mechanism will be devised in the near future.

#### **4.4 Powers of the Netherlands Court of Audit**

Under Article 87 of the Government Accounts Act 2001, the Netherlands Court of Audit is entitled to audit any central government department or unit, if it believes that it needs to do so in order to discharge its duties. This means that, as far as the guarantee scheme is concerned, the Court is entitled to perform an audit at the Ministry of Finance.

Article 91 (1c) of the Government Accounts Act 2001 grants the Court certain limited powers in relation to legal entities, limited partnerships and general partnerships to which the state, or a third party acting at the state's risk and expense, has issued a grant, loan or guarantee, either directly or indirectly. Where loans, grants and guarantees are concerned, however, the Court is not empowered to audit financial undertakings (see Article 91 (16) of the Government Accounts Act 2001).

The Netherlands Authority for the Financial Markets is responsible for supervising the banking and insurance markets, whilst the Dutch central bank is responsible for the prudential supervision of the financial institutions and for supervising the stability of the financial system. Article 91 of the Government Accounts Act 2001 grants the Court certain powers with regard to both the Netherlands Authority for the Financial Markets and the Dutch central bank as financial regulators. The duties of the Dutch central bank in relation to the enforcement of the Treaty establishing the European Community are covered by the Court's general powers as set out in Article 87 (1) of the Government Accounts Act 2001, rather than by the specific powers granted under Article 91 (see paragraphs 3 and 4). Incidentally, the Explanatory Memorandum to the Government Accounts Act 2001 states that the Court is not entitled to have access to information held by the Dutch central bank on individual persons or companies.



## 5 EXTENSION OF BANK DEPOSIT GUARANTEE SCHEME

<b>Nature of intervention:</b>	Extension of bank deposit guarantee scheme
<b>Date:</b>	7 October 2008
<b>Amount involved:</b>	No immediate impact on the state, as any guarantee claims are divided among the banks taking part in the scheme.

### 5.1 Extension of coverage of bank deposit guarantee scheme

In pursuance of two EU directives,<sup>15</sup> there is a guarantee scheme in operation in the Netherlands that offers a limited form of protection in the event of the compulsory liquidation of a licensed credit institution. In the Netherlands, the regulations governing the scheme are set out in the Special Prudential Measures, Investor Compensation and Deposit Guarantees (Financial Supervision Act) Decree of 12 October 2006. The Dutch central bank is responsible for managing the scheme.

The bank deposit guarantee scheme as it used to operate in the Netherlands covered bank deposits up to a value of €40,000, with a 10% excess applying to balances of between €20,000 and €40,000. On 7 October 2008, the Minister of Finance announced that the ceiling for the scheme would be raised to €100,000 and that depositors would not be liable for any excess. This extension of the scheme was the result of talks in the Council of European Ministers of Finance on a joint strategy for restoring confidence in the financial sector. In the first instance, the new ceiling applied only up to the end of September 2009. In March 2009, however, the Minister decided to extend this period to 31 December 2010. The rise in the level of coverage of the Dutch bank deposit

<sup>15</sup> These are the directive on deposit-guarantee schemes (94/19/EC; OJ L 135/5 of 31 May 1994) and the directive on investor-compensation schemes (97/9/EC; OJ L 84/22 of 26 March 1997).



guarantee scheme and the ending of the excess, i.e. the amount for which savers themselves are liable, were both formally announced in Government Gazette 211 of 15 October 2008.

In October 2008, the EU finance ministers presented a proposal for amending Council Directive 94/19/EC<sup>16</sup> that would set a pan-European ceiling of €100,000, to take effect from 2011. The ministers also proposed reducing the deadline for the repayment to savers who have lost their deposits from three months to three days. After discussing the proposals, the EU member states decided to set the deadline at 20 days, with the possibility of a ten-day extension of this period in exceptional circumstances. The member states also decided to fully harmonise bank deposit guarantee schemes in Europe so that they were all subject to the same ceiling of €100,000, and that this change would take effect from 31 December 2010.

## **5.2 Terms of the bank deposit guarantee scheme**

The Special Prudential Measures, Investor Compensation and Deposit Guarantees (Financial Supervision Act) Decree sets out certain rules on qualification for the deposit guarantee. The decree also states which banks and other financial institutions are covered by the scheme, describes the procedures that need to be followed and sets a deadline for the making of payments.

If a bank becomes insolvent, the Dutch central bank is responsible for enforcing the guarantee scheme. The amount disbursed by the Dutch central bank is then divided among the banks that are members of the scheme, using a formula given in the decree. In principle, therefore, the Dutch central bank simply makes an advance payment which it subsequently recovers from the members of the scheme, which means that the operation of the scheme should not result in either the Dutch central bank or the state making any net payments. Under the terms of the scheme, the size of a bank's annual contributions as calculated in accordance with the formula in the decree may not exceed 5% of its equity capital. If a contribution exceeds this figure, the Dutch central bank is required to advance the amount in question interest-free.

The events surrounding the compulsory liquidation of Van der Hoop Bankiers showed that, because of certain loopholes in the law, it made a

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<sup>16</sup> COM (2008) 661; 2008/0199 (COD).



huge difference whether claimants first submitted a claim to the administrator and then made a claim under the bank deposit guarantee scheme, or whether they acted in the reverse order. This loophole has now been closed with the aid of emergency legislation.<sup>17</sup>

In reply to a request from the Finance Committee of the House of Representatives, the Minister of Finance stated that no accurate figures were available on the size of the balances covered by the bank deposit guarantee scheme.<sup>18</sup>

### 5.3 Assessing compliance

The Dutch central bank is responsible for managing the bank deposit guarantee scheme in the Netherlands, which also covers branches of banks based in other countries of the European Economic Area (EEA).<sup>19</sup> The basic principle in the EEA is that of home country control, which means that the regulatory authorities in the home country are also responsible for supervising the activities of branches of banks based in other countries. Banks are allowed to operate in other EEA countries under a licence issued by the regulator in their home country. This system is a consequence of European law<sup>20</sup> and has been enshrined in the Netherlands in the Financial Supervision Act.

In the case of a branch owned by a bank based in another EEA country, the supervisory role of the regulatory authorities in the host country is limited to monitoring the branch's liquidity position. Another consequence of the principle of home country control is that banks holding a licence from an EEA member state are subject to the bank deposit guarantee scheme that is in force in that particular member state. In order to guarantee equal treatment, the relevant EU legislation states that, if the bank deposit guarantee scheme in the home country has a lower level of coverage than the scheme operating in the host country, the branch can 'top-up' the value of the guarantee by joining the host-country scheme. Even where this type of topping-up arrangement has been made with the Dutch central bank, the Dutch authorities will nonetheless assume that the branch in question is being supervised by the regulator in its home

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<sup>17</sup> Act of 14 February 2008; Bulletin of Acts and Decrees 2009, 106.

<sup>18</sup> Letter of 31 March 2009 from the Minister of Finance (ref. FM/2009/M679).

<sup>19</sup> The EEA consists of the EU member states, plus Norway, Iceland and Liechtenstein.

<sup>20</sup> Council Directive 94/19/EC.



country. In practice, this means that the Dutch authorities may not have a clear picture of the potential risks associated with such branches.

#### **5.4 Powers of the Netherlands Court of Audit**

Under Article 87 of the Government Accounts Act 2001, the Netherlands Court of Audit is entitled to audit any central government department or unit, if it believes that it needs to do so in order to discharge its duties. This means that, as far as the policy on the bank deposit guarantee scheme is concerned, the Court is entitled to perform an audit at the Ministry of Finance.

The Dutch central bank is responsible for the operation of the bank deposit guarantee scheme. Article 91 of the Government Accounts Act 2001 grants the Court certain powers with regard to the Dutch central bank as a financial regulator. The duties of the Dutch central bank in relation to the enforcement of the Treaty establishing the European Community are covered by the Court's general powers as set out in Article 87 (1) of the Government Accounts Act 2001, rather than by the specific powers granted under Article 91 (see paragraphs 3 and 4). Incidentally, the Explanatory Memorandum to the Government Accounts Act 2001 states that the Court is not entitled to have access to information held by the Dutch central bank on individual persons or companies.



## 6 PREFUNDING OF BANK DEPOSIT GUARANTEE PAYMENTS MADE IN RELATION TO ICELAND

<b>Nature of intervention:</b>	Prefunding of bank deposit guarantee payments made in relation to Iceland
<b>Date:</b>	11 October 2008
<b>Amount involved:</b>	€1.236 billion worth of expenditure according to the 2008 Annual Report on the Ministry of Finance (IXB). This sum will have to be repaid by the Icelandic bank deposit guarantee scheme. The extension of the coverage provided by the Dutch bank deposit guarantee scheme will oblige the Dutch central bank, and hence the state, to spend an additional sum, estimated at €106 million. This is because, although the extension of the scheme also applies to Icesave account-holders, it is not possible to divide the payments over the Dutch banks that are members of the scheme.

### 6.1 Payments under bank deposit guarantee scheme for Iceland

At the beginning of October 2008, the Dutch branch of an Icelandic bank called Landsbanki, which was trading under the name of Icesave, found itself no longer able to pay funds to savers wishing to draw on their accounts.

The Dutch state takes the view that Iceland is under an obligation to pay Dutch Icesave account-holders a sum of €20,887 per account, given that this is the extent of the cover provided by the Icelandic bank deposit guarantee scheme. A letter to the House of Representatives<sup>21</sup> refers to

<sup>21</sup> House of Representatives, 2008-2009 session, 31 371, no. 18.





the issue of 'topping-up' the guarantee for Icesave account-holders, so as to bring it up to the level of cover provided by the Dutch scheme. This topping-up arrangement was agreed by the Dutch central bank and the agency responsible for managing the Icelandic bank deposit guarantee scheme, and meant in practice that balances held with Icesave were guaranteed to €40,000 instead of €20,887, as had previously been the case. There is a 10% excess for which savers themselves are liable, between the figures of €20,000 and €40,000. Any payments made under the topping-up arrangement are charged to the banks who are members of the Dutch guarantee scheme, in accordance with a given formula.

On 7 October 2008, the Minister of Finance announced that the general ceiling for the scheme would be raised to €100,000.<sup>22</sup> The Minister of Finance stated, in a letter to the House of Representatives,<sup>23</sup> that the Dutch state was liable for the extra cover provided between €40,000 and €100,000, as well as the 10% excess applying to sums between €20,000 and €40,000, because the decision to extend the cover was taken at a time when Icesave was already in difficulties. This departure from the provisions of the Special Prudential Measures, Investor Compensation and Deposit Guarantees (Financial Supervision Act) Decree has not been formalised, and is based only on a letter from the Treasurer General to the Dutch central bank.

Replying to questions in the House of Representatives, the Minister of Finance said that he expects claims from savers (in relation to balances up to €20,000) to total approximately €1.3 billion. He said that the Dutch state would have to pay around €92 million in the form of compensation for losses in excess of €40,000 and for losses for which savers had previously been liable themselves.<sup>24</sup> When we terminated our audit at the end of March 2009, the latest estimate of the amount for which the state would be liable had risen to €106 million. For the time being, the Dutch central bank has advanced this amount until the extent of the banks' own liability is clear and all appeals have been heard.

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<sup>22</sup> See the separate table with information on the extension of the bank deposit guarantee scheme.

<sup>23</sup> House of Representatives, 2008-2009 session, 31 371, no. 21.

<sup>24</sup> House of Representatives, 2008-2009 session, 31 371, no. 97.



## 6.2 Terms and conditions

The Minister of Finance informed the House of Representatives<sup>25</sup> that the Dutch state intended to grant a ten-year loan to the Icelandic bank deposit guarantee scheme that would be fully backed by a guarantee from the state of Iceland. The rate of interest would be based on the pre-crisis market rate and the loan would be paid directly to the Dutch central bank. A Memorandum of Understanding (MoU) was signed with the Icelandic authorities on 11 October 2008, setting out the terms and conditions applying to the loan. On the date on which we completed our audit, i.e. 31 March 2009, no loan contract had yet been signed with the Icelandic government.

The general terms and conditions for claims under the bank deposit guarantee scheme are set out in the Special Prudential Measures, Investor Compensation and Deposit Guarantees (Financial Supervision Act) Decree. These include, for example, the list of criteria that need to be satisfied by private individuals in order to qualify for the guarantee, the extent of the guarantee in the case of a joint account and the procedure for setting-off guarantee payments against any debts owed by account-holders.

## 6.3 Assessing compliance

The Dutch central bank is responsible for dealing with guarantee claims received from Icesave account-holders. The Dutch central bank first assesses whether the claims meet the criteria in the Special Prudential Measures, Investor Compensation and Deposit Guarantees (Financial Supervision Act) Decree. The central bank also assesses whether they satisfy the provisions of the Icelandic bank deposit guarantee scheme, given that, under the MoU signed with the Icelandic authorities, the Dutch central bank is responsible for administering the scheme insofar as it applies to Dutch Icesave account-holders.

The Financial Markets Department, the Financial and Economic Affairs Department and the Internal Audit Department at the Ministry of Finance are responsible for checking the accuracy of the information received from the Dutch central bank regarding payments made under the bank deposit guarantee scheme and the prefunding of such payments. The

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<sup>25</sup> House of Representatives, 2008-2009 session, 31 371, no. 21.



amount paid in prefunding the bank deposit guarantee payments for Iceland, i.e. €1.236 billion, falls under the unqualified opinion issued by the Ministry's Internal Audit Department on the 2008 Annual Report on the Ministry of Finance.

The Financial Markets Department at the Ministry of Finance is responsible for both drafting and enforcing the loan contract signed on the basis of the MoU.

## **6.4 Powers of the Netherlands Court of Audit**

Under Article 87 of the Government Accounts Act 2001, the Netherlands Court of Audit is entitled to audit any central government department or unit, if it believes that it needs to do so in order to discharge its duties. This means that, as far as the guarantee scheme for Icesave account-holders (and the prefunding of guarantee payments) is concerned, the Court is entitled to perform an audit at the Ministry of Finance.

Article 91 (1c) of the Government Accounts Act 2001 grants the Court certain limited powers in relation to legal entities, limited partnerships and general partnerships to which the state, or a third party acting at the state's risk and expense, has issued a grant, loan or guarantee, either directly or indirectly. Where loans, grants and guarantees are concerned, however, the Court is not empowered to audit financial undertakings (see Article 91 (16) of the Government Accounts Act 2001).

The Court's powers as set out in Article 91 of the Government Accounts Act 2001 do not in any event apply to the Icelandic bank deposit guarantee scheme if a loan contract is signed with the state of the Netherlands. The Court does not have any powers outside the Netherlands in this connection.

Article 91 of the Government Accounts Act 2001 grants the Court certain powers with regard to both the Netherlands Authority for the Financial Markets and the Dutch central bank as financial regulators. The duties of the Dutch central bank in relation to the enforcement of the Treaty establishing the European Community are covered by the Court's general powers as set out in Article 87 (1) of the Government Accounts Act 2001, rather than by the specific powers granted under Article 91 (see paragraphs 3 and 4). Incidentally, the Explanatory Memorandum to the Government Accounts Act 2001 states that the Court is not entitled to



have access to information held by the Dutch central bank on individual persons or companies.



## 7 BACK-UP FACILITY FOR ING

<b>Nature of intervention:</b>	In order to limit the amount of ING's capital that needs to be reserved to cover its securitised mortgage portfolios, a back-up facility was devised in consultation with the Dutch central bank that transfers to the state a share of the potential profits and losses emanating from the portfolio.
<b>Date:</b>	26 January 2009
<b>Amount involved:</b>	After depreciation, the securitised mortgage portfolio is valued at USD 35.1 billion (€27 billion). According to the Provisional Account for 2008, the arrangement should lead to the state receiving net revenue of approximately €230 million in 2009.

### 7.1 Explanation of back-up facility

Like many other international banks, ING had built up a portfolio of securitised mortgage loans. Unfortunately, the credit crunch put the brakes on the trade in this type of loan. With the trade in ING's Alt-A portfolio<sup>26</sup> at a standstill, its market value plummeted. In accordance with the International Financial Reporting Standards (IFRS), ING was required to ensure that the balance sheet reflected the depreciation in the value of these illiquid assets by forming a revaluation reserve, which in turn had the effect of weakening its equity. In the end, ING found that its ability to borrow was under threat.

Under the arrangement, the state has agreed to grant ING an 'illiquid assets back-up facility'. A letter to the House of Representatives<sup>27</sup> states

<sup>26</sup> The portfolio consists of around 1,100 bonds issued by intermediaries. The latter package various types of mortgage loans (i.e. assets) so as to issue them as bonds.

<sup>27</sup> House of Representatives, 2008-2009 session, 31 371, no. 95.



that the facility should be regarded as a means of dispelling the doubts surrounding the illiquid assets held by financial institutions.

The back-up facility consists of a series of dollar-denominated cash flows simulating a purchase transaction, resulting in the state and ING together dividing the profits and losses (or potential profits and losses) stemming from the Alt-A portfolio at a ratio of 4:1, i.e. with the state taking 80% and ING accounting for the remaining 20%. The aim of this arrangement is to lessen the risk to ING's equity capital in the event of a decline in the market value of its Alt-A portfolio. Moreover, any decline in the market value does not affect the bank's equity, as there is no need to include a negative revaluation reserve on its balance sheet.

Under the reporting rules used by ING for the transaction, it is entitled to regard it as a transfer of financial assets. Although ING retains a contractual right to the cash flows, it is also under a contractual obligation to pay the incoming cash flows to the state. In other words, the arrangement does not legally constitute a purchase, which means that ING retains the legal title to the portfolio. In economic terms, the arrangement is equivalent to a cash-flow transaction for the state, whilst for ING it has the equivalent effect to the sale of part (i.e. 80%) of its Alt-A portfolio.

The Alt-A portfolio was capitalised on ING's balance sheet at a value of around USD 39 billion. Because the portfolio's economic value fell as a result of the credit crunch, the Minister of Finance instructed a specialist firm called Dynamic Credit Partners to assess the portfolio's economic value. Based on the research performed by Dynamic Credit Partners, the Alt-A portfolio was first depreciated by 10% to USD 35.1 billion (i.e. to 90% of its initial value) prior to the signing of the contract. Under the terms of the contract governing the back-up facility, the state's 80% share is valued at USD 27.85 billion.

**Table 2 Value of ING's Alt-A portfolio**

Amounts in bn	US dollars	Euros <sup>1</sup>
Initial value of Alt-A portfolio	39	30
Downgrading	4	3
Value after depreciation (approximate economic value)	35	27
State share (80%)	28	22
ING share (20%)	7	5

<sup>1</sup>Based on the dollar exchange rate on 26 January 2009 (i.e. the date of the transaction).



Two different scenarios were used for valuing the bonds in the Alt-A portfolio. In both cases, projections were made of the expected future cash flows resulting from the bonds, based on an analysis of the underlying mortgages.<sup>28</sup> This calculation suggested that there was a 75% probability of the state earning a profit, and a 25% risk of the state making a loss. In other words, the ultimate financial outcome ranges from a profit of USD 2 billion to a loss of USD 0.6 billion.

The state and ING share the profits and losses made from the portfolio at a ratio of 4:1. The state receives 80% of the cash flow from every bond in the portfolio (i.e. interest, repayments of principal and repayments before maturity), plus a guarantee fee from ING in return for accepting liability for the risk involved. The state pays ING a management fee for managing the portfolio, as well as a funding fee for providing the funding. In the Provisional Account for 2008, the revenues for 2009 are estimated at €4.149 billion. The expenditures are estimated at €3.919 billion. This leaves an estimated profit for the state of approximately €230 million in 2009.

The net cash flow resulting from the back-up facility affects the EMU<sup>29</sup> balance. The only other aspect that is relevant to the state is the economic value (rather than the market value) of the Alt-A portfolio. This is because the reporting requirements the state is required to observe are not the same as those applying to ING.

## 7.2 Contract terms

On 26 January 2009, ING and the state agreed on a term sheet for an 'Illiquid Assets Back-up Facility Agreement'. ING posted the term sheet on its website. A more detailed version of the term sheet was subsequently produced in the form of a document known as the 'Long Documentations', which was signed on 31 March 2009. A letter from the Minister of Finance to the House of Representatives<sup>30</sup> states that the agreement involves a number of different cash flows and that the parties are required to pay a variety of fees to each other. These financial terms and conditions are listed in the term sheet and are defined in more detail in the Long Documentations.

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<sup>28</sup> See also: House of Representatives, 2008-2009 session, 31 371, no. 125.

<sup>29</sup> European Monetary Union.

<sup>30</sup> House of Representatives, 2008-2009 session, 31 371, no. 95.



The state receives 80% of the interest payments and repayments of principal made for the mortgage loans in the portfolio. The state also receives an annual 0.55% guarantee fee, payable on its declining share of the portfolio. The state pays ING a guaranteed annual fee for repaying the state's share of the portfolio, in accordance with a predefined fee schedule. The state also pays a funding fee on its declining share of the portfolio, which is divided into a fixed and variable component. Finally, the state pays an annual 0.25% management fee on its own, declining share of the portfolio.

ING is responsible for paying all costs relating to the above transactions. The state runs a currency risk, given that the cash flows are dollar-denominated. As both the revenues and the payments are denominated in dollars, the currency risk is in fact limited to the risk in relation to the net cash flows.

Table 3 shows the cash flows as indicated in the Long Documentations.

**Table 3 Cash flows as indicated in the Long Documentations**

	For:	Calculated as follows:
<b>ING ⇒ state</b>		
Cash flows from portfolio	Cash flows: interest and repayment of principal, including repayments before maturity	80% of the revenue earned on the portfolio
Guarantee fee	Accepting liability for the risk involved	Annual fee of 0.55% of the state's declining share of the portfolio
<b>State ⇒ ING</b>		
Management fee	Managing the portfolio	Annual fee of 0.25% of the state's declining share of the portfolio
Funding fee	Funding the portfolio	Fixed annual fee of 3.5% + variable component <sup>1</sup>
Guaranteed payments	Repaying the portfolio	Guaranteed annual repayment in accordance with a pre-agreed repayment schedule

<sup>1</sup>Based on LIBOR (London Interbank Offered Rate) + 50 basis points.

The term sheet for the back-up facility states that the state needs to give its consent to decisions relating to the management of the portfolio and the underlying securities. These include, for example, a decision to sell the underlying securities, to alter the terms and conditions pertaining to





the underlying securities or to pledge or securitise the underlying securities.

As regards the term of the facility, it is in theory conceivable that the facility will remain in operation until the last mortgage loan in the portfolio has been repaid. This means that there could be cash flows between ING and the state resulting from this transaction until the year 2048. The back-up facility may, however, be terminated at an earlier date if the state and ING reach agreement on the market value at which the outstanding portfolio may be sold. The state and ING will meet every year to discuss the possibility of terminating the facility. The state has devised two incentives for encouraging the bank to terminate the facility earlier than planned: firstly, there is a gradual rise in the size of the guarantee fee paid by ING; secondly, ING is obliged to sell the underlying securities, i.e. the bonds, once the price at which they are traded on the open market is again the same as the price ING originally paid for them.

Alongside the financial terms and conditions applying to the back-up facility, it is also subject to a number of other conditions, notably in relation to governance issues such as the remuneration policy. The governance terms and conditions already agreed for the €10 billion capital injection in ING will remain in operation throughout the duration of the back-up facility. The members of ING's Executive Board have decided to waive their rights to all bonuses for 2009 and subsequent years until a new remuneration policy has been adopted. The two government-nominated supervisory directors are required to give their consent to the appointment of ING's CEO.

In addition, ING has also committed itself to disbursing an extra €25 billion in loans to consumers and businesses in the Netherlands, to continuing to make use of the PIN-based<sup>31</sup> payment system and to making active use of the €200 billion guarantee facility for a sum of €10 billion. It is not entirely clear what the status of these terms is. The Minister of Finance has informed the House of Representatives that they are conditions to which ING has committed itself at its own instigation.<sup>32</sup> Finally, in addition to making use of the back-up facility, ING will also take various additional steps to reduce its risk-weighted assets<sup>33</sup> by 3%. ING has promised in this connection to shorten its balance sheet, reduce

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<sup>31</sup> This is on condition that other financial institutions also stick with the PIN-based system.

<sup>32</sup> House of Representatives, 2008-2009 session, 31 371, no. 97.

<sup>33</sup> The degree of risk attaching to each class of asset is weighted in calculating the bank's minimum capital requirement.



the level of risk, sell certain business units and to try and free up some of its equity.

### **7.3 Assessing compliance with the contract terms**

The back-up facility has been made available *inter alia* on condition that ING reports either to the state or to its auditors on the bonds (including cash flows and the value, performance and composition of the portfolio), the borrowers or obligors, and any other information the state may require. The Minister of Finance is planning to draw up a standard reporting template for this purpose. This had not yet been finalised when the Long Documentations were signed at the end of March 2009. The Ministry of Finance has not yet made full provision for the activities resulting from the back-up facility. The idea will be for the Dutch State Treasury Agency to set up a back office to handle the administrative side of the various cash flows. ING is obliged to give the state's auditors access to any documents they wish to inspect in order to audit the cash flows stemming from the back-up facility.

The government-nominated supervisory directors play a key role in supervising the bank's compliance with the non-financial terms of the back-up facility. According to a letter from the Minister of Finance to the House of Representatives, ING will itself report on whether it has honoured its pledge to lend an extra €25 billion in the Netherlands.<sup>34</sup>

The European Commission is responsible for assessing whether the back-up facility complies with European law and has yet to take a final decision on the facility. On 31 March 2009, the Commission issued a temporary permit for six months. During this time, the Commission will investigate whether the facility contains any elements that could represent an unacceptable form of state aid.

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<sup>34</sup> House of Representatives, 2008-2009 session, 31 371, no. 125.



## **7.4 Powers of the Netherlands Court of Audit**

Under Article 87 of the Government Accounts Act 2001, the Netherlands Court of Audit is entitled to audit any central government department or unit, if it believes that it needs to do so in order to discharge its duties. This means that the Court is entitled to perform an audit at the Ministry of Finance into the back-up facility for ING.

Article 91 (1c) of the Government Accounts Act 2001 grants the Court certain limited powers in relation to legal entities, limited partnerships and general partnerships to which the state, or a third party acting at the state's risk and expense, has issued a grant, loan or guarantee, either directly or indirectly. Where loans, grants and guarantees are concerned, however, the Court is not empowered to audit financial undertakings (see Article 91 (16) of the Government Accounts Act 2001). For the time being, we are ignoring the question of whether the back-up facility may be classified as a grant, a loan or a guarantee.

Article 91 of the Government Accounts Act 2001 grants the Court certain powers with regard to both the Netherlands Authority for the Financial Markets and the Dutch central bank as financial regulators. The duties of the Dutch central bank in relation to the enforcement of the Treaty establishing the European Community are covered by the Court's general powers as set out in Article 87 (1) of the Government Accounts Act 2001, rather than by the specific powers granted under Article 91 (see paragraphs 3 and 4). Incidentally, the Explanatory Memorandum to the Government Accounts Act 2001 states that the Court is not entitled to have access to information held by the Dutch central bank on individual persons or companies.



## **8 RESPONSE OF MINISTER AND AFTERWORD OF NETHERLANDS COURT OF AUDIT**

### **Minister's response**

The Minister of Finance responded to the report entitled *The Financial Crisis 2008-2009* when he responded to the regularity audit for 2008. We have posted the full text of the Minister's response on our website ([www.rekenkamer.nl](http://www.rekenkamer.nl)).

In his response to the report entitled *The Financial Crisis 2008-2009*, the Minister of Finance referred to the passage on the Court's powers of audit in relation to the state's shareholdings in the members of the Fortis group. The Court stated that it was assuming for the time being that its powers with regard to the shareholdings recently acquired by the state were as defined in Article 91 (1a) of the Government Accounts Act 2001. The Minister pointed out that those responsible for drafting the Act did not foresee such an exceptional situation and, accordingly, had not made provision for it. He proposed meeting with Court representatives in order to agree on its powers in relation to these shareholdings.

### **Afterword of Netherlands Court of Audit**

It goes without saying that the Court is willing to meet the Minister of Finance in order to discuss its powers under Article 91 (1a) of the Government Accounts Act 2001 in relation to state shareholdings.