Working on trust

DNB seeks to safeguard financial stability and thus contributes to sustainable prosperity in the Netherlands.

To this end, DNB operates as an independent central bank and supervisor to ensure:
- price stability and balanced macroeconomic development in Europe, together with the other central banks of the Eurosystem;
- a shock-resilient financial system and a secure, reliable and efficient payment system;
- strong and sound financial institutions that meet their obligations.

By issuing independent economic advice, DNB strengthens policies aimed at its primary targets.
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Gross domestic product (GDP), used to express quantities in some tables and charts, is GDP at market price unless stated otherwise.

Legend
0 (0.0) = the figure is less than half of the rounding used or nil;
blank = a figure cannot logically occur or the data are not reported (to DNB);
. = no data available.

Rounding
Figures may not add up due to automatic rounding per series; rounding per table means that there is not always a smooth transition between tables.
Governing Board, Supervisory Board, Bank Council and Employees Council

At the adoption of the 2013 Financial Statements, the Governing Board, Supervisory Board, Bank Council and Employees Council of De Nederlandsche Bank were composed as follows:

**Governing Board**

*President:* Klaas Knot.
*Executive Directors:* Joanne Kellermann, Jan Sijbrand, Frank Elderson and Job Swank.

*Company Secretary:* Louisa van den Broek.
Supervisory Board

Chairman: Alexander Rinnooy Kan (1949, Dutch)
Member of the Supervisory Board since 2012. (End of current term: 2016)
Member of the Remuneration and Appointments Committee.
Observer member of the Supervision Committee.
University Professor of Economics and Business at the University of Amsterdam.

Vice-chairman: Annemiek Fentener van Vlissingen (1961, Dutch)
Member of the Supervisory Board since 2007. (End of current term: 2015)
Chairman of the Remuneration and Appointments Committee.
Chairman of the Supervisory Board of SHV Holding NV.

Secretary: Bert van Delden (1941, Dutch)
Member of the Supervisory Board since 2004. (End of third and final term: 2016)
Member of the Supervision Committee.
Member of the Bank Council on behalf of the Supervisory Board since 2004.

Other members:
Kees Goudswaard (1955, Dutch)
Member of the Supervisory Board since 2012. (End of current term: 2016)
Member of the Audit Committee.
Member of the Supervision Committee.
Professor of Applied Economics and Professor by special appointment of Social Security at Leiden University.

Jaap van Manen (1950, Dutch)
Member of the Supervisory Board since 2011. (End of current term: 2015)
Chairman of the Audit Committee.
Professor of Corporate Governance at the University of Groningen.

Feike Sijbesma (1959, Dutch)
Member of the Supervisory Board since 2012. (End of current term: 2016)
Member of the Remuneration and Appointments Committee.
Chairman of the Managing Board of DSM.

Hélène Vletter-van Dort (1964, Dutch)
Member of the Supervisory Board since 2010. (End of current term: 2014)
Chairman of the Supervision Committee.
Professor of Financial Law and Governance at Erasmus University Rotterdam and Professor by special appointment of Securities Law at the University of Groningen.

Government-appointed member:
Wim Kuijken (1952, Dutch)
Member of the Supervisory Board since 2012. (End of current term: 2016)
Member of the Audit Committee.
Member of the Remuneration and Appointments Committee.
(As of 1 January 2014)
Member of the Bank Council since 2012.
Delta Programme Commissioner/ABDTOPConsultant.
Remuneration and Appointments Committee
Annemiek Fentener van Vlissingen, Chairman
Alexander Rinnooy Kan
Feike Sijbesma
Wim Kuijken (as of 1 January 2014)

Audit Committee
Jaap van Manen, Chairman
Wim Kuijken
Kees Goudswaard

Supervision Committee
Hélène Vletter-van Dort, Chairman
Bert van Delden
Kees Goudswaard
Alexander Rinnooy Kan, Observer member

Bank Council
Chairman: Arnoud Boot
Professor of Corporate Finance and Financial Markets at the University of Amsterdam.

Members:
Bert van Delden
Member of the Supervisory Board.

Wim Kuijken
Government-appointed member.

Chris Buijink (as of 1 June 2013, successor to Boele Staal)
Chairman of the Netherlands Bankers’ Association.

Harry Garretsen
Professor of Economics and Dean at the University of Groningen.

Ton Heerds
Chairman of FNV.

Marco Keim
Chairman of the Dutch Association of Insurers.

Maurice Limmen (as of 1 January 2014, successor to Jaap Smit)
Chairman of CNV.

Albert Jan Maat
Chairman of LTO Nederland.

Kick van der Pol
Chairman of the Federation of the Dutch Pension Funds.

Michaël van Straalen (as of 1 September 2013, successor to Hans Biesheuvel)
Chairman of MKB-Nederland.
Reginald Visser  
Chairman of MHP.

Bernard Wientjes  
Chairman of VNO-NCW.

Representative of the Ministry of Finance:  
Hans Vlijbrief, Treasurer General.

Bernard Wientjes was reappointed for a period of four years, with effect from 1 July 2013

Employees Council

Eleonora van Erp  
Johan de Feijter  
Lineke Galama  
Saideh Hashemi  
Steven Jonk  
Nico Kloosterman (Chairman)  
Miriam Kraal (Chairman)  
Jan Meinster  
Jerry Rijmers  
Paul Suilen  
Marjolein van der Vlugt  
Ingrid Voorn  
Peter Wagelmans  
Jos Westerweele  
(Vacancy)  
Sandra Koentjes (professional secretary)
Introduction by the President
Introduction by the President

This Report was published in the year in which De Nederlandsche Bank celebrates its 200th anniversary. From its inception in 1814, DNB has acted as the guardian of financial stability. Of course, this role has changed its nature over the years. However, it was clear from the start that financial stability is an indispensable ingredient of sustainable welfare. It is a precondition for balanced economic growth, which in turn generates the resources underlying social cohesion, sustained development and, importantly, long-term planning.

The financial crisis that impacted the world over five years ago now, illustrates this complex intertwining. This crisis caused financial disruption on a global scale and efforts to restore stability have come at a high cost to society in the form of substantial unemployment and loss of income. Such developments may exacerbate existing social tensions, such as those associated with access to and use of energy and natural resources. In discharging its duties, DNB has contributed to financial stability and hence to sustainable welfare, throughout its 200-year existence.

A further increase of sustainable welfare in our country requires focussed policy commitment in a number of areas. To begin with, the cyclical situation increasingly permits a return to a strict interpretation of the Dutch trend-based budgetary policy, preferably including the former cautious projections of economic growth. This will provide a clear framework for the options open to the Government in consolidating its balance sheet and restoring its financial robustness. Thus it will contribute to administrative calm and prevent unpaid bills from being left for future generations. Also, changes in our society, such as shifting employment patterns and demographic ageing, have compelled us to question the sustainability of existing arrangements, specifically as regards pensions and health care. The Cabinet’s promise of a fundamental discussion on the Dutch pension system is therefore to be welcomed, and a similar debate on the funding of our health care system would be advisable. We will return to this issue below.

2013 was the year that saw stabilisation of the global economy and, towards the end, a tentative clearing of the cyclical clouds. This happened, and is still happening, at varying rates. The United States are currently in the lead, followed by the euro area, including the Netherlands as a cyclical latecomer. This slow recovery is partly due to the severity of the losses sustained and national differences in the nature of the problems. Another factor is the degree of vigour with which policy reactions have been pursued. Policymakers have taken measures to repair the damage caused by the financial crisis. In Europe, an essential step has been the decision to create a banking union, and reforms in important areas have also been agreed at the Dutch national level. Still, major efforts remain to be undertaken in several areas.
Global economic recovery gains momentum in late 2013

In 2013, the global economy grew by some 3%, gaining additional momentum towards the end of the year. A further pick-up of global economic activity is expected. The fact that most of the growth acceleration was attributable to the developed countries shows that the dynamics driving global economic growth are shifting from the emerging to the developed countries. The former will still record a higher growth rate of around 5% in 2014. Yet the shift is remarkable, as it used to be the emerging economies that – helped by expansionary monetary and budgetary policies – acted as the powerhouse of the world economy immediately following the outbreak of the crisis.

In the United States, growth picked up speed in the course of 2013. Economic recovery was also recorded by the United Kingdom, a major trading partner of the euro area. In Japan, the stated growth strategy is paying off. Although in a longer perspective, the United States has lost weight as a global economic player, the country is still the main trading partner of many countries. It is home to the world’s most important financial centre and to the international reserve currency. Thanks to these commercial and financial channels, the global economic cycle depends in large part on that of the United States. Under the impact of continued recovery of the US balance sheet, consistently accommodating monetary policy and a declining rate of budgetary consolidation, US economic growth will pick up in the coming years, resuming its role as the engine of global recovery. Paradoxically, however, this role also poses a risk to the world economy. As the US economy regains its cyclical steadiness, the unconventional monetary stimulus will be tapered off. The sustainability of global economic recovery will crucially depend on the gradual and controlled draining off of the current reservoir of US dollar liquidity, which is expected to cause a global increase in the cost of capital. If successful, this will enable the accelerating growth of world trade, driven by resurging global demand, to offset the influence of less abundant global liquidity conditions.

Vulnerability of emerging economies

Growth perspectives of the many emerging countries that are particularly sensitive to the effect of the ‘tapering’ policy have deteriorated relative to pre-crisis times. In those days, economies profited from strongly rising commodity prices, an export-driven growth model, consistently relaxed monetary and budgetary policies and high domestic credit growth. In recent years, many of these factors turned against the economies of emerging countries. Countries that have pegged their exchange rates to the US dollar and countries where imbalances have built up in recent years are now particularly vulnerable. This showed when in mid-2013 financial markets started to anticipate the Federal Reserve Board’s decision to phase out its expansionary liquidity policy. Countries including Brazil, India, Indonesia, South Africa and Turkey began to feel the effect of consequent portfolio reallocations on their economies. Relaxed monetary policies in these countries had fuelled increased capital inflows and in some cases substantial domestic credit expansion and concomitant build-up of large foreign debts, often denominated in foreign currency and carrying short maturities. If tapering entails the uncontrolled adjustment of global capital flows, this will have adverse effects on such vulnerable countries, both as regards the business cycle and in terms of financial stability. Conversely, a controlled adjustment may trigger a growth slowdown to more sustainable levels. Intensification of global trade as a result of a cyclical resurge in developed countries may stimulate such developments. A second factor that may help to
achieve such a soft landing is continued dynamism in the Chinese economy, which drives economic activity in many Asiatic and commodity producing countries. The same applies to the pursuit of policies aimed to reinforce the economic structure and the creation of conditions for sustainable growth. Increasingly, emerging economies find themselves faced with structural factors that depress their potential growth rates, such as low investment efficiency, demographic ageing and a sub-optimal average education level. Especially in emerging Asia, potential growth in recent years has turned out below expectations. Encouragingly, China has drawn up an ambitious reform agenda. In this country, the earlier growth strategy based on high investment activity has led to imbalances and vulnerabilities, especially in and around the financial sector. The reform agenda envisions economic restructuring such that more room is created for consumer spending and a services sector.

Global growth faces inherent risks
The fact that the foundation for recovery of global growth appears to have been laid, does not mean that such recovery will be particularly strong or risk-free. Underlying problems – the unhealthy financial condition of households, financial institutions and governments, plus the global excess liquidity – are too big. Apart from the risks attending the controlled draining of global excess liquidity, buffer accumulation and debt reduction will take time. Also, the financial problems in many countries have depressed potential growth. A return to growth levels prevailing just before the crisis erupted is therefore unlikely. Sustained welfare will benefit from sustainable, stable growth and a resilient financial sector. Policymakers the world over have committed themselves to this, each from their own area of responsibility. These responsibilities tend to be organised along national lines. At the same time, the credit crisis once more demonstrated the close international interdependency of all components of the world economy. The fact that few if any protectionist measures were taken in response to the crisis shows that historical lessons have been put into practice. In December 2013, the Member States of the World Trade Organisation successfully concluded negotiations in the context of the so-called Doha Round. The resulting multilateral trade agreement will benefit the growth of global trade. This achievement also illustrates the strength of balanced international policy coordination that takes account of external effects.

The euro area: continue on course
As the year progressed, the euro area recorded its first modest positive economic growth since the crisis. Expectations are that the cyclical landscape will continue to clear up gradually. Yet growth remains subdued and will remain – across countries, sectors and spending categories – heterogeneous, if only because of ongoing balance sheet adjustments. Elsewhere, too, many improvements have been made in a relatively short period. European political leaders have decided on the creation of a banking union – about which more will be said below. Many countries consolidated their public finances and implemented structural reforms. Macroeconomic imbalances decreased, as did the financial fragmentation among Member States. Relative calm returned to financial markets. The adjustment programmes for Ireland and Spain could be rounded off successfully in December 2013. The return of sustainable calm and growth will require many further steps, however, and the improvements so far must not lead to a slackening of reform agendas. The current rosier outlook and the gradual return of confidence are, after all, largely the result of expectations.
Introduction by the President

raised by actions taken earlier by governments and central banks. The continued involvement of the International Monetary Fund (IMF) in European adjustment programmes is highly desirable in this context; such involvement furthers the objectivity, modalities, thoroughness and funding of adjustment programmes and has proved its value over the past few years. Yet the first responsibility for effecting more far-reaching reforms and structural improvements lies with the countries themselves. This is after all in their own interest. A matter for concern is that while countries under a support programme have made substantial steps forward, the pace of reform in large countries such as Italy and France has been disappointing.

Imbalances abating slowly, partly due to reforms

The macroeconomic imbalances within the euro area, whose painful effects became all too evident during the crisis, have begun to even out. At the same time, the much-needed strengthening of balance sheets in the private and public sectors has slowly been getting off the ground. Budget consolidation last year helped reduce the funding deficit prevailing in the euro area. In most countries, this has not yet led to a reduction of public sector debt ratios, partly because the recession has dragged down nominal growth of gross domestic product (GDP). Private debts, however, appear close to the turnaround point. They have been clearly receding in Spain and Ireland. Given the size to which private and public debts have grown, it will take several more years to reduce them to sustainable levels. For reduction of public debt, the amended European budget rules, effective from January 2013, serve as guiding principles. In the current environment of high indebtedness, Member States remain vulnerable to unexpected shifts in market sentiment. Governments will therefore do wise to formulate any growth-stimulating measures in such a way that they do not result in higher public debt. Intensification of public investments could, for instance, be compensated for by spending cuts elsewhere in the budget.

The current account deficits of vulnerable Member States were strongly reduced or even converted into a small surplus. To some extent, this is due to severe economic recession in those countries. Yet in Spain, Portugal, Ireland and Greece, competitiveness is improving at a growing pace through labour cost moderation. This is partly thanks to reforms in the wage setting framework leaving more room for decentralised wage negotiations. In Spain and Greece, company labour agreements now prevail over sector-wide agreements, whereas in Portugal and Italy there is still room for improvement. In Spain, wage-setting would also benefit by discontinuing the traditional practice of price-indexed salaries. However, the improvement in the cost of labour has not translated everywhere into lower sales prices. Further promotion of competition in product and services markets throughout the Economic and Monetary Union (EMU), as by the removal of restrictive legislation and barriers to start-up companies, could be useful in this respect. Macroeconomic imbalances exist throughout the EMU and it rests upon every Member State to reduce them. Deficit countries will find that the elimination of imbalances first and foremost serves their own economic robustness and secondly, by implication, that of the currency union. In surplus countries, reforms enhance the national growth potential and hence that of the EMU.

The reform of euro area product and, especially, services markets clearly lags behind that of labour markets. This is a cause for concern, not least because the functioning of those markets is intertwined, so that a lack of reform in one restricts the effectiveness of reforms in the other. If there is more competition in
product and services markets, wage moderation will moreover lead to lower prices and not cause a mere shift from labour to capital. In recent years, especially the southern Member States have laid the foundations for more efficient allocation of and increased demand for, labour by relaxation of employment protection measures. In countries such as Portugal, Spain and Italy, a further relaxation of the right of dismissal in existing contracts deserves to be given priority, as does a relaxation of rules for collective dismissal in Greece and Ireland. Yet essential for the effectiveness of such reforms is not only the de jure impact of legislation but also, and especially, its de facto impact. The latter is sometimes influenced by factors such as bureaucracy, judicial efficiency, clientelism and, in some cases, corruption. The latest Global Competitiveness Report of the World Economic Forum, for instance, points to the adverse influence of bureaucracy in most euro area countries, and to the presence of corruption in countries such as Greece and Italy. Also mentioned are vulnerabilities arising from the inefficiency of law courts in Greece, Italy and Portugal. Therefore judicial reforms in Portugal and Italy are welcome developments.

**Financing economic activity**

In the effort to enhance the robustness of the euro area, the financing of economic activity is a cause for some concern. Debates have focussed on the questions whether lending to the private sector, whose growth in the euro area has weakened from 11.7% in 2007 to -1.0% in 2013, reflects depressed demand-side developments or limited financial resources in the financial sector. This debate is one-sided, however, because what is essential is not the amount of credit but where in the economy the credit lands. Prior to the crisis, for instance, credit growth in some southern areas of the euro area was mainly attributable to households and real estate-related segments of the economy. There, the credit contributed to imbalances in the housing market and the construction industry. In such countries, the drop in lending that followed the crisis was a painful but – in terms of sustainability – necessary development. At the same time, sustainable recovery in the more vulnerable countries of the euro area stands to benefit from lending to producers of exportable goods and services. Such lending may accelerate the necessary adjustment of the economic structure. However, parts of these vulnerable countries have seen lending to such export sectors decline in recent years. This is a cause for concern. Also worrisome is the fact that recently established and small companies in the euro area are currently having difficulty in finding access to funding, if only because this category includes innovative start-ups. Such companies play a prominent role in creating future productivity growth. For this and other reasons, expansion of financing possibilities, as through the further development of capital and stock markets and of venture capital is of importance. The European Commission’s recent study into the financing of the European economy provides important recommendations, also relevant to the Netherlands. Examples are better and more transparent disclosure on credit ratings, an increase of private lending and the promotion of high-quality, straightforward securitisations.

**Banking union**

The banks of course play a major role in the financing of economic activity in the euro area. Banks are increasingly enabled to do so as they are better capitalised and the creation of the banking union dampens the negative interaction between the solvency of Member States and of banks. As a result,
market confidence in the European banking industry can increase further. 
The banking union is a major structural reform in Europe that is being realised 
in relatively little time. The speed at which the banking union is being set up 
reflects the pressure from financial markets and the solidity of the support base 
among policymakers regarding the necessity of this structural reform for 
economic welfare. The first element of the banking union that is to become 
operational, on 4 November 2014, is supranational supervision. Preceding its 
introduction is a comprehensive asset quality review (AQR) of the largest banks 
in the euro area. This AQR will provide transparency on the financial condition 
of the banks within the scope of European supervision. The effectiveness of 
such a review increases if clear and credible agreements are made on the specific 
implementation of the safety net in case the AQR identifies a capital deficit. 
The final responsibility for the prudential supervision of all banks in the 
participating Member States will rest with the ECB, which will cooperate closely 
with national supervisors, including DNB. How the ECB will exercise its 
supervision will depend on the position of the particular bank in the financial 
system. In this context, the ECB will act as the direct supervisor for some 130 
larger, significant banks through dedicated joint supervisory teams composed of 
staff from the ECB and national supervisors. The less significant banks will 
come under the ECB’s indirect supervision, while direct supervision will 
continue to be exercised by the national supervisors. The ECB may choose to 
bring such less significant banks under its direct supervision as well. European 
banking supervision will bring new supervisory methods and processes and new 
information needs, while the ECB will on-charge the costs of its supervisory 
work directly to the banking communities in the several Member States. 
It stands to reason that banking supervision will become more costly as a result, 
regardless of DNB’s continuous efforts to organise banking supervision in the 
Netherlands as efficiently as possible.

The banking union will allocate staff for both the supervision of banks and the 
resolution of problem banks at the supranational level. This constitutes an 
important step forward, for without an adequate, independently financed 
European resolution mechanism, the orderly resolution of banks will continue 
to rely on funding by the national banking community or government. 
This would perpetuate the negative interaction between financial institutions 
and national authorities. It might even spark a conflict with European, that is 
supranational, supervision. European resolution aims to prevent future repeats 
of the current excessive level of financial fragmentation between Member States, 
and thus to contribute towards a level playing field that benefits a European 
internal financial services market. With Europe-wide risk sharing, moreover, 
a European resolution fund may be smaller than the sum total of national 
funds. Yet while welcome in themselves, the current proposals on European 
resolution still provide for only gradual, and ultimately incomplete, severance of 
the ties between banks and Member States over a period of ten years. Nor has 
the safety net of the European resolution fund been given concrete shape. 
In this respect, European supervision, resolution and financing have not been 
adequately aligned. To the extent that risks remain at the national level, 
Member States will have to maintain larger financial buffers and higher overall 
reserves will be needed. This illustrates the more general principle that holding 
on to national sovereignty within a currency union carries a price tag.

At the same time, the European resolution framework aims to limit recourse to 
public funds if a bank collapses, through the ‘bail-in’ instrument. 
This instrument is used to write down corporate liabilities or convert them into 
shares when a bank is in or close to default. Thus it serves to protect taxpayers.
If the bail-in instrument is to function properly, it is recommended that banks build a clear funding structure including a sufficiently large and explicit bail-in layer. This will offer transparency to capital providers, thus enhancing the credibility of bail-in measures and reducing the uncertainty surrounding their possible effect. Also, it will enable markets to make an accurate estimate of the actual financing costs – that is, the costs net of implicit state subsidy through the deployment of public funds.

**Unconventional monetary policy**

The decision-making process surrounding the banking union is welcome also from a monetary policy perspective. Monetary authorities played an essential role in reducing financial fragmentation in the euro area, yet monetary policy cannot remove its root causes, such as the negative interaction between Member States and banks. Like many other central banks, the ECB has fielded a broad range of unconventional monetary measures since the outbreak of the credit and debt crises. Bottlenecks in the monetary transmission mechanism were to some extent freed up through expanded liquidity provision to banks. At the same time, the collateral framework was relaxed so as to reduce the collateral scarcity faced by counterparties, and so-called outright monetary transactions (OMT) were announced in order to stave off disorderly conditions in government bond markets. The unconventional monetary policy of the ECB was subsequently relieved as banks became better capitalised, taking their cue from the new Basel supervisory requirements. Another relief factor formed the structural steps made to decouple banks and governments from each other. It is important that the unconventional monetary policy measures should not be overburdened: they may cause unintentional side effects and new risks, especially if maintained for too long. A persistently dominant role of the central bank in money and capital markets may disrupt the smooth and disciplined operation of those markets, causing market parties to resume excessively risk-seeking behaviour. Another risk is that the interdependence between (central) banks and governments increases, for instance due to the large size of the central bank balance sheet in general and of the government bond portfolio on that balance sheet in particular.

Over the longer term, the high amount of liquidity created by the unconventional policy measures of the ECB poses a risk to price and financial stability. Premature normalisation may harm the recovery of the business cycle, whereas a late exit could, via excessive asset price inflation, give rise to new bubbles and subsequent disruptions. To be sure, the prudent design of the unconventional measures limited some of the negative side-effects. Setting conditions on the access to ECB financing facilities may impart the right incentives.

The unconventional policy measures should, in due time, be phased out gradually. Even though the design of the refinancing facilities in the euro area facilitates a more or less automatic exit, their termination will have to be communicated with due care. At all times, a clear distinction should be made between conventional and unconventional policy measures. Communication on the use of conventional policy instruments centres on the future development of the inflation rate. The unconventional policy targets the operation of the monetary transmission mechanism. A complicating factor is the fact that this mechanism itself evolves over time, partly under the impact of the economy’s response to changes in the environment. The financial crisis has caused changes to the financial landscape and the regulatory regime, which in turn will affect the
transmission mechanism. Bank lending, for instance, may come to respond differently to movements in the policy rate.

**Dutch economy on the way up again**

In the course of 2013 the Dutch economy began to grow again. It has, however, sustained a stiff blow from the financial crisis. At end-2013, GDP volume still stood some 3% below the level attained just before the credit crisis erupted. Moreover, the improving macroeconomic picture masks strongly different sectoral developments. Most of the recovery is accounted for by large companies. Small and medium-sized companies are still experiencing more difficulty.

**The underlying strength of the Dutch economy**

Before economic growth can gather confident speed again, a long, slow and bumpy road will have to be travelled. But there is no reason for gloom either. The quality of our main production factor, human capital, is high by international standards and the same applies to the average financial strength of the Dutch. Although not back to pre-crisis levels yet, the average net financial assets of Dutch households are among the largest in the industrialised world. Also comforting is the fact that in 2013 several parties showed responsibility by agreeing on institutional changes in such structurally important economic areas as the housing market, the pension system, social security and the financial sector. These reforms are intended to make the Dutch economy more flexible and, hence, more resilient. Although they bring a mix of pleasure and pain to everyone, the reforms also provide clarity and as such they have stimulated Dutch people’s confidence in the economy. At end-2013, for instance, consumer confidence stood 24 points higher than at its low point in February. It is now imperative that all intended reforms, including those not completely implemented, be pursued with vigour. This will demand discipline, because sustainable economic recovery also requires ongoing balance sheet adjustments. For although encouraging steps have been made, the much-needed deleveraging in both the public and private sectors is still far from complete. Balance sheet restructuring takes time, particularly in the current vulnerable economic conditions.

**Sustainable welfare growth requires additional reforms**

Apart from the implementation of agreed reforms, further economic recovery will require patience. Strategic economic policy can best be geared towards creating conditions for sustainable welfare in a period after the economy has overcome the effects of the crisis. This will involve efforts to make the Dutch economy more robust. Regarding the public sector, it is recommended that a critical look be taken at the composition and level of public expenditure. Public spending, net of interest payments and the (cyclical) costs of unemployment and social support benefits, increased by almost 4% of GDP between 2008 and 2012. This increase was largely accounted for by health care spending, which also rose on an international scale. This is one of the reasons why the Coalition agreement includes measures to curb the growth of health care spending. The scope and depth of any additional measures require political choices to be made. Notably, health care in the Netherlands relies mainly on collective funding. As a result, incentives are weak for both users and providers of care to use care resources as effectively as possible. Incentives for providers might be reinforced by emphasising public health results rather than number of treatments. On the demand side, patient contributions might increase cost effectiveness.
Restructuring of the public sector balance sheet would benefit from a return to a stricter interpretation of ‘trend-based budgetary policy’. While trend-based principles have underlain budgetary policy since 1994, successive Cabinets have in recent years amended these policy principles in a manner that is not conducive to dampening cyclical effects or to the creation of governmental stability. Also, European budgetary rules, which since the introduction of the Sustainable Public Finances Act on 1 January 2014 have enjoyed legal priority in the debate on the Dutch national budget, impede the operation of trend-based budgetary policy. The current improving cyclical conditions offer room for a reformed and intensified trend-based budget policy. Such a policy should include reintroduction of the so-called cautious economic growth projection at the start of a Cabinet term. This also applies to the agreement to allocate any budgetary windfalls entirely to the budget balance. Yet even if European rules should at any point reassert their restraining hold on Dutch budgetary policy, the need for political calm should still prevail. It may be achieved through the introduction of a correction mechanism providing for the automatic cancellation of specific spending increases or tax reductions to prevent non-compliance with European budgetary rules.

To ease the budget balancing process and to confront the growing issue of demographic ageing it is important that the earning capability of the Dutch economy should be increased. Structural reforms are needed, not least because our country faces a period where levelling population growth will exert negative pressure on the potential growth rate. The labour participation of Dutch women has increased in recent years, although the part-time component of the labour market leaves room for further growth. At the same time, participation in the 55–64 years age bracket has increased considerably, a trend which will be reinforced in coming years as the pensionable age rises. Reduction of the costs associated with the dismissal of employees in this age bracket, which the Cabinet intends to achieve, will make the 55–64-year old more employable and thus increase their labour participation. But these effects are temporary in nature. Dutch structural growth potential will increasingly have to rely on growing labour productivity. High labour productivity is fostered mainly by good institutions and high-quality human capital. An important element, in a small and open economy such as ours, is the capability to absorb the knowledge and innovations of others. Dutch education enjoys high international standing, and scores well above the OECD average. Moreover, OECD research shows, the universal professional skills of the Dutch, which are expected to play an important role in growth and innovation over the next few decades, are excellent.

Apart from higher investment in human capital, investing in physical capital goods may also contribute towards increasing Dutch earning capacity. Investments by Dutch enterprises have dropped sharply since the crisis and are now lagging behind companies in other EU countries. Cross-border investments have grown, though, encouraged by increased opportunities for outsourcing of capital intensive production processes. Dutch enterprises may in recent years have shifted some emphasis across the border owing to the presence of many multinationals in combination with a relatively small and open economy. This would partly explain the strong difference among enterprises according to size. Larger companies emphasise exports and enjoy a relatively favourable outlook. Also, they have sufficient internal resources available and are relatively profitable. Medium-sized and especially small companies, by contrast, have been hard hit by a sharply contracted domestic demand, have limited internal resources and are less profitable. Evidently, the low level of investment activity
is to some extent due to the restructuring of the real estate sector that has been going on apace since 2008. Resurging transaction volumes in the housing market and a moderate increase of construction order portfolios since the summer of 2013 suggest that the real estate sector may be past its low point and will gradually exert less downward pressure on domestic investment growth. However, the fact that sales of existing homes are picking up does not imply the prospect of a rapid return to housing price levels that prevailed before the crisis. This would be neither realistic nor desirable, as ebbing tax subsidies and more restrained lending policies make for lower sustainable housing prices.

**Access to corporate financing**

For many companies, the ability to invest depends importantly on access to external financing. In recent years, this access has become less easy, especially for companies that rely on bank financing, including a large proportion of non-exporting medium-sized and small companies. Surveys show that limitations on bank lending to such companies are associated with increased credit risks stemming from the cyclical downturn. Another limiting factor has been the restrictive lending policies of banks facing inevitable and necessary balance sheet restructuring. A healthy banking industry will thus create the best climate for healthy corporate lending conditions. Dutch banks are well on their way towards meeting the more stringent capital and liquidity regulations of the Basel III Capital Accord. The stronger buffers required under Basel III will considerably increase banks’ resilience.

The financial crisis has illustrated the importance of broadened access to corporate financing. A major step in this direction would be a dedicated programme or action plan charting existing impediments and suggesting possible solutions. Such a programme could take on board insights offered by recent domestic and international studies and could lead to financing concepts complementary to the banking channel. A facilitating role in this respect could be fulfilled by the Dutch Investment Institution (Nederlandse Investeringsinstelling) currently being formed. Companies with low disposable capital, especially start-ups, have a need for more risk-bearing financing provided by venture capitalists or by the general public (crowdfunding). Other possibilities may include a more prominent role for institutional investors, more private equity or debt issuance, the provision of subsidies and guarantees, the growth of credit unions and, especially, the deepening of European capital markets through the harmonisation of bankruptcy and tax legislation.

Underlying such alternatives, which will anyway require considerable time to come to maturity, will have to be the utmost transparency regarding inherent risks and their ultimate bearers. Such inherent risks are often substantial, especially in SME lending, and should as a rule be borne by private investors rather than taxpayers. Investors must be enabled to calculate their own exposures. Here, too, risk transparency helps, for instance in the form of better data files providing commensurable financial information at the firm level.

**Financial resilience of households**

Households’ financial resilience will benefit by the shortening of household balance sheets. While the net financial assets of Dutch households are large, much are held in illiquid forms such as the family home or pension rights. And offsetting the assets are large debts (mainly mortgages). This constellation makes households vulnerable to adverse financial shocks. It also makes the Dutch economy vulnerable to the interaction between the housing market,
the banking industry and the pension system, because it reinforces cyclical movements, thereby increasing uncertainties. How the household balance sheets are to be reduced is a matter for political debate. Since it affects several sectors, including the housing market, the pension sector and the financial sector generally, the balance sheet restructuring process will be both complex and comprehensive. It is therefore advisable to pursue a policy of gradual implementation. It is promising that political decisions have already been made in a number of areas, such as tax aspects of both home-ownership and pension saving. The correlation between home mortgage lending and pension saving in the Netherlands reflects their interdependency in terms of tax treatment. The political decisions now taken have created greater clarity, and individuals will adjust their behaviour accordingly. The decisions limiting tax-free pension saving and increasing the pensionable age have been a welcome but only first step. This view is shared by the Cabinet. The envisioned fundamental debate surrounding the Dutch pension system should therefore be initiated in the near future. This fundamental debate should include deliberations on the best possible combination of collective and individual elements in the resulting new pension system. The debate should also include the preferred level of variability in pension contributions, benefits and accumulation. These elements are interrelated. It will be impossible to create stability in each of these three dimensions simultaneously. Stable contributions can be implemented through variable accumulation rates, variable pension benefits or a combination of both. Choices made in this area will also have major implications on the macroeconomic level. A pension system that exerts minimal autonomous effect on cyclical movements, for instance, will enhance public confidence in the economy. Even regardless of household balance sheet issues, it is important that our pension system be adjusted to current changes in society, where demographic ageing plays an increasing role and employment patterns are subject to sweeping changes. These developments suggest a system that allows for more differentiation and, thus, individual freedom of choice. Strong points of the system that should be preserved include the prominent role of capital funding and the mandatory nature of pension accumulation, while solidarity mechanisms should be kept transparent and a broad support base for the envisioned reforms should be actively sought.

The Dutch financial sector and its supervision

Sustainable economic growth requires a healthy financial sector. Regarding the latter, major steps forward have been made. International legislation has been tightened. For banks, the new regime is largely informed by the views of the Basel Committee on Banking Supervision. The outlines of European banking supervision in the context of the banking union have already been discussed above. Regarding insurance supervision, an important European agreement that brings closer the introduction of Solvency II by 1 January 2016, was reached in late 2013. The intervening period will have to be devoted to the gradual implementation of the new framework along with close monitoring of its operation and adjustment where needed. While alertness to any unintentional side effects is in order with a view to effectiveness, this structural reform must also be implemented according to plan. This is because the restoration of confidence in the financial sector, which is a major precondition for robust economic recovery, will depend on strict implementation of and adherence to new, tightened legislation.

DNB bases the exercise of its supervisory duties on a periodically updated strategy delineating the supervisory framework. This DNB Supervisory Strategy is
re-calibrated every four years on the basis of domestic and international developments. The recently published DNB Supervisory Strategy 2014–2018 takes into account the recommendations of several inquiry committees and the lessons learned from past experience in the supervisory field, such as the LIBOR fraud and the nationalisation of SNS Reaal. The new Supervisory Strategy puts greater emphasis on the integrity and governance of the financial sector, including bonus policies, and provides details on several aspects of the European banking union and on the additional buffer requirements imposed on banks. Insurance supervision will shortly become more risk-oriented and forward-looking, partly because medium-sized and larger insurers are required to apply the theoretical solvency criterion.

Since 2010, DNB has considerably tightened its prudential supervision. A completely new top-down risk analysis method has been introduced, leading to greater discipline and consistency in the supervisory process. The new analysis starts with the translation of macroprudential risks as published by DNB in its Overview of Financial Stability, to the risk profile of the individual insurance entity. Macroprudential risks may relate to the economy as a whole or an entire economic sector, but also to business models, conduct and culture aspects, infrastructure or ICT. These risks now constitute important input elements for the determination of individual institutions’ risk profiles and the actions they require to be taken. A crucial element in DNB’s risk analysis is the way institutions manage their risks. Increasingly, DNB analyses these prudential risks on a sector-wide level, for instance through thematic examinations into the effectiveness of institutions’ financial and operational risk management and their internal audit function. Such thematic examinations are also used to establish cross-institutional benchmarks. Aspects covered in that context include conduct and culture, business models and strategies.

On 1 February 2013, the Minister of Finance decided, in close consultation with DNB, to nationalise SNS Reaal. In a market economy, nationalisation should always be considered as the measure of last resort. DNB therefore explored every avenue in order to avoid having to use this measure. Numerous alternatives involving private sector parties and solutions were examined. Yet the central objective pursued by DNB at all times was to safeguard financial stability in the Netherlands. That must never be allowed to be endangered. Only when it transpired that none of the alternatives would bring relief was the nationalisation instrument employed in order to safeguard financial stability in the Netherlands.

**Regulatory framework for pension supervision**

As a supervisor, DNB attaches high importance to an adequate and sustainable pension system. A system where pension funds realise to a satisfactory degree the ambitions encased in the pension scheme and the expectations of their members. A major factor in attaining this goal is the review of the Financial Assessment Framework (‘the Framework’). DNB advises the Ministry of Social Affairs and Employment on the substance of the Framework and assesses the implementation aspects of relevant draft legislation. The review of the Framework is a necessary measure and will be worked out in detail this year. It is essential that this work will be undertaken with energy, so as to help ensure the solidity of the pension sector and effect the necessary restoration of confidence in the system. In the longer term, the sustainability of the pension system also demands more far-reaching adjustments, as discussed earlier.
Macroprudential supervision in practice

In addition to healthy and resilient financial institutions, a robust financial system is also essential. Therefore, the promotion of financial stability has, from 1 January 2014, been enacted in the Bank Act as one of the duties of DNB. To fulfil this duty, DNB has been given new macroprudential powers on the strength of new European legislation. For one thing, DNB now has power to require banks, in times of rapid credit growth, to accumulate an additional capital buffer to be drawn down in less buoyant conditions. Most of the new instruments envision enhancement of the financial system’s robustness, acting on the market conduct of – and interaction between – financial institutions. Because instruments cannot be linked to individual financial stability risks, the new powers target intermediary goals, such as countering excessive credit growth and unwarranted maturity transformation. These goals in themselves already provide sufficient cause for action and form the essential links in the spread of financial instability.

DNB intends to observe the greatest possible transparency regarding the use of macroprudential instruments. Transparency thus contributes to predictability, which in turn may influence expectations and hence lead to more desirable behaviour. Also, it may help enlarge the support base for measures taken. Finally, transparency enhances the accountability of DNB as a macroprudential authority.

The payment system: reliable and innovative

An element that is central to the financial system and important in shaping the interdependency between individual financial institutions is the payment system. The role played by the payment system usually remains underexposed, until problems such as the DDoS attacks of April 2013 illustrate the social importance of smoothly operating payment infrastructures. The DDoS attacks could be countered relatively quickly. The subsequent survey by the National Forum on the Payment System showed that representative organisations in the Netherlands regard the payment infrastructure as robust. The payment system of the Netherlands is efficient and meets high technological standards. As such it is an attractive target for criminals. Therefore robustness requires ongoing efforts to counter threats. For one thing, measures have been taken to prevent illegal gains from being made through copying bank cards, almost eliminating this ‘skimming’ practice. DNB sees to it that institutions respond adequately to developments in the payment system and the concomitant risks, and that they continue to take appropriate action. In this context DNB welcomes its new statutory powers, conferred on 1 January 2014, to exercise payment system supervision or ‘oversight’ over major players.

Along with the ongoing innovation race, abuse of the payment system manifests itself in ever-changing guises. At the same time, innovation is the source of permanent improvements in the payment system, by which society may benefit. If attacks cannot be prevented entirely, they may be made controllable and their consequences manageable. A well-known innovation in the payment system has been the rise of a new, virtual currency called bitcoin. Acceptance of this decentralised, cryptography-based system has been limited but growing. However, the bitcoin is not legal tender and acceptance is never mandatory. Nor can bitcoins lay claim to the reliability of legal tender, issued by a central bank and supported by a public safety net for the money-creating banking industry. Also, few prices are quoted in bitcoin, which is therefore hardly used as a unit of account. The price of the bitcoin is set in the market and includes a liquidity premium. The virtual currency is subject to fluctuations in both value and liquidity. In 2013, therefore, the exchange rate of the bitcoin against, for instance, the euro varied enormously, reducing the attractiveness of the bitcoin as a
hoarding currency. Since the bitcoin network is largely anonymous, the virtual
currency is an attractive target for criminal activities. Regulation of the bitcoin is
next to impossible. Users must realise the risk of price and other loss. All in all,
it is uncertain whether the use of the bitcoin will ever take off to an extent where it
may compete sustainably with official money.

The year 2014 will see the introduction of the SEPA European payment system.
This marks an event of historic importance, because after the introduction of the
non-cash euro in 1999 and the cash euro in 2002, SEPA also forms a major pillar of
the single euro payments market. SEPA marks a new phase in the standardisation
of the European payment system. Individuals and businesses throughout Europe
will be able to pay each other with uniform instruments. The distinction between
domestic and cross-border payments in euro no longer exists for direct debits and
credit transfers inside the EU, and cross-border payments cost the same as
domestic payments. Consumers stand to benefit by SEPA, although they will have
to get accustomed to the new, longer IBAN bank account numbers. Consumers
will also benefit because banks may now compete on the entire European
payments market. This offers opportunities for the development of new,
innovative payment services that may be used throughout the euro area. However,
banks and businesses have had to make heavy investments for the implementation
of SEPA. A compliment is due to Dutch banks and businesses for their efforts to
make SEPA possible.
Interdependence of growth and financial stability
I Interdependence of growth and financial stability

1.1 Introduction

One of the most important lessons to be drawn from the onset and aftermath of the credit crisis is that financial stability and robust economic growth are inextricably linked. Substantial progress has been made in the necessary balance sheet repair, but the process is not yet complete. One positive note is that the Dutch economy began to grow again in mid-2013, though the growth outlook for the coming years is modest. Attention must therefore now turn to increasing the Dutch economic growth capacity and achieving a sustainable recovery of financial stability. This chapter discusses four selected topics that highlight substantial challenges in this regard.

Section 1.2 focuses on the structural capacity for growth in the Dutch economy. The key question addressed here concerns the scope for strengthening that capacity, and in particular the role of lending in that process. Section 1.3 discusses the macroprudential policy of De Nederlandsche Bank (DNB). With effect from 1 January 2014, DNB’s task of promoting financial stability is embedded in the Bank Act (Bankwet), and macroprudential policy provides the necessary tools for this task. This section outlines the operationalisation of macroprudential policy in the Netherlands. Section 1.4 takes a broader view by looking at the Economic and Monetary Union (EMU) and exploring how the EMU area is recovering from the debt crisis. The willingness of the European Central Bank (ECB) to make conditional purchases of euro area government bonds through Outright Monetary Transactions (OMTs), together with the launch of the banking union, largely restored calm to the financial markets. In addition, the divergence in financial performance between the euro countries has narrowed. However, ensuring sustainable calm requires a further reduction in the macroeconomic imbalances in the EMU. The concluding section of this chapter (Section 1.5) addresses the ECB’s unconventional monetary policy, which has helped restore calm to the financial markets. Due to its unintended side-effects, this unconventional policy also has a number of drawbacks. The potential negative economic impact of an exit from the unconventional monetary policy is also reviewed in this section. Clear communication is crucial in avoiding this impact as far as possible.
Interdependence of growth and financial stability

1.2 **From balance sheet repair to growth**

Economic recovery is being held back by the need for households, government and financial institutions to strengthen their balance sheets. Fundamentally, the Dutch economy is in good shape. Continuing to work towards a healthy banking sector, investing in the labour force and further strengthening labour market institutions are all initiatives that will increase the structural capacity for growth.

1.2.1 *Balance sheet problems slow down economic recovery*

The Dutch economy is recovering more slowly from the crisis than other core euro area countries. The crux of the problem is sluggish domestic spending – not just private consumption, but also investments in housing and other assets. Chart 1.1 shows that private consumption in the Netherlands has made a predominantly negative contribution to GDP growth since 2009, whereas in other core countries that contribution has been consistently positive.

The chief explanation for the shortfall in private consumption is the development of real disposable household income (see Chart 1.2), which has been under additional pressure since the crisis due to a variety of factors. First, there has been virtually no increase in nominal wages. Balance sheet repair by the government and pension funds has also constrained the indexation of pension and other benefits, while households have faced a number of increases in direct taxes and...
social insurance contributions. In addition, inflation has remained persistently high, partly due to increases in indirect taxes. But consumer spending has also suffered from the damaged household balance sheets, especially in the form of lower home equity and the resultant increase in residual debt. And individual household savings have been showing negative growth for ten years, restricting the scope for more consumption.

Balance sheet repair takes time. Introducing a number of targeted measures could speed up this adjustment process and support spending over time. But first of all, it is important that underwater homeowners are able to obtain bank finance for the residual debt; this is facilitated by government policy. A reduction in pension accrual, as long as it is accompanied by lower pension contributions, also creates scope for an increase in net wages. Responsible pay increases in sectors that are in good health could create additional financial headroom as well. Meanwhile, the way in which the government implements its fiscal consolidation will play a role. Gross public expenditure has risen sharply in recent years, from just over 45% of GDP in 2007 to around 50% in 2013. Financing this increase without an excessive rise in the budget deficit has required hikes in taxes and social insurance contributions. This is part of the reason for the decline in disposable household income. A critical review is therefore needed of the level and composition of public spending.

Costs of health care are a key cause of the higher public expenditure. Spending on health care rose from 8.7% of GDP in 2007 to 11.0% of GDP in 2013. The average annual increase over that period was almost 4% in real terms.

**Chart 1.2 - Real disposable household income**

Percentage changes and contributions in percentage points

<table>
<thead>
<tr>
<th>Pension contributions (-)</th>
<th>Direct taxes and other social insurance contributions (-)</th>
<th>Inflation (-)</th>
<th>Social security benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other primary income (net)</td>
<td>Employee remuneration</td>
<td>Disposable income (net, real)</td>
<td></td>
</tr>
</tbody>
</table>

Note: 2013 based on the first three quarters.
Source: Statistics Netherlands and DNB.
This sharp rise makes it painfully clear that the predominantly publicly funded Dutch health care system is running up against the buffers. In relative terms, households’ out-of-pocket contributions to the health care they use are exceptionally low in the Netherlands. Because such a large proportion of health care costs are publicly funded, the present system offers inadequate incentives for both users and providers to ensure optimum effectiveness. Placing more emphasis in health care funding on results rather than number of treatments could boost incentives for health care providers, while higher patient co-payments could also improve cost-effectiveness.

The rising costs of health care are also directly linked to faltering private consumption. The ‘individual public consumption’ – the proportion of public expenditure that goes directly to individuals, such as spending on health care and education – is relatively high in the Netherlands. In other countries, people have to use more of their disposable income to pay for these services. As a result, a comparison with the euro area of actual individual consumption, i.e. private consumption plus individual public consumption, reveals a more favourable balance (see Chart 1.3).

1.2.2 Squeeze on bank lending demands broadening of the credit market

Bank lending growth has fallen sharply in the Netherlands since 2009. Mortgage lending to households is barely growing at all, rising by 0.6% year-on-year in December 2013. Growth of lending to non-financial businesses has also slowed and has actually contracted since July 2013. This limited lending growth is related to falling demand for credit, which is normal in a recession, but is currently exacerbated by the deterioration in the housing market. However,
Supply factors also play a role (see Box 1.1). First, banks have tightened up their lending criteria because of the increased credit risk. The SME sector has been particularly hard hit by the recession, and is carrying a relatively high proportion of payment arrears. An added factor affecting mortgage lending is the policy of banks to limit their relatively large exposure in view of the concentration risk. Mortgage lending growth is also being squeezed by stricter regulations on repayment options and loan-to-value limits.

A number of specific developments at banks have also affected lending since the crisis. First, the dependence of Dutch banks on market funding has made them hesitant to take on long-term loans due to the higher refinancing costs and risks. This applies particularly to residential mortgages, but also to business, where

**Box 1.1 Study of supply factors underlying the lower credit growth**

Research by DNB underlines the role of supply factors in the lower credit growth. Its analysis shows that banks’ stricter lending policies, combined with the decline in demand for credit, has led to an estimated fall in business lending growth of between two and four percentage points (see Chart 1.4; post-crisis hypothetical scenario).

The SME sector is also facing stricter bank lending criteria, with several banks continuing in 2013 to use the increased credit risk, the access to market funding and their capital position as reasons to further tighten their lending policies (see Chart 1.5). The results of the study show that, by applying stricter criteria, banks have restricted the growth in total business lending. The measures include higher collateral requirements, smaller loan amounts and all manner of covenants written into contracts.

**Chart 1.4 - Impact of bank lending policy on business lending**

Annual growth in bank lending to businesses, in percentages

<table>
<thead>
<tr>
<th>Actual growth</th>
<th>Hypothetical growth without relaxation of lending policy from 2004</th>
<th>Hypothetical growth without tightening of lending policy from 2009</th>
<th>Long-term average since 1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-crisis - hypothetical scenario</td>
<td>Post-crisis - hypothetical scenario</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Computation of results in DNB Working Paper No. 396.
Source: DNB.
more than three-quarters of the outstanding volume comprises loans with terms exceeding one year. Within the business loan portfolio, loans to the SME sector, which is relatively heavily dependent on banks for finance, have particularly long terms. Banks are also working to strengthen their balance sheets, and restricting lending is one way to meet the capital requirements. However, the extent to which the necessary strengthening of their balance sheets contributes to banks’ reticence to extend business loans is uncertain.

A broadening of the funding market is desirable in order to counter the present squeeze on bank lending and to diversify the financial system in the longer term. Expanding the availability of finance could help reduce the SME sector’s dependency on banks in the coming years. SMEs must be provided with finance, not only through loans but also in the form of equity, because capital reinforcement will improve both their financial position and their access to bank lending.

Alternative forms of finance, such as microfinance, crowdfunding, credit unions and venture capital, are growing but continue to be niche markets. Securitisation of mortgage and SME loans on bank balance sheets can also offer a solution.

The study also shows that (overly) generous bank lending policies before the crisis contributed to excessive credit growth at the time (see Chart 1.4; pre-crisis hypothetical scenario). If banks had not relaxed their lending criteria from 2004, lending growth in 2006 and 2007 would have been between two and six percentage points lower. This analysis contributes to the validation of macroprudential policy in the Netherlands. DNB has acquired new macroprudential instruments in 2014 which it can use to counter excessive lending growth (Section 1.3 takes a closer look at these instruments. The crisis has revealed that some loans were granted too readily before the crisis, for example in the commercial real estate market. The current limited lending growth is also related to the inevitable deleveraging after the earlier strong rise in lending.
Institutional investors can contribute as well. Examples include the creation of the National Mortgage Institute and the Dutch Investment Institute, as well as recent initiatives to set up investment funds specifically targeting the SME sector. Finally, the funding options could be increased if bankruptcy and fiscal legislation were harmonised across Europe, if European and national SME support programmes were streamlined and databases were set up to provide better insight into the credit quality of the SME sector. This could facilitate the development of a broader credit market, as was the case in the United States and the United Kingdom.

1.2.3 Structural growth outlook

As in many other countries, slowing population growth means the Netherlands will be confronted with structurally lower economic growth. After all, prosperity does not depend on overall economic growth, but on per capita income growth. Key factors here are the labour participation rate, the number of hours worked and the hourly productivity rate.

The labour participation rate has risen sharply in the Netherlands over recent decades (see Chart 1.6). At the end of the 1980s, the total participation rate in the Netherlands was relatively low compared with other European countries. However, since the mid-1990s, the participation rate has been above average, mainly thanks to the increased number of women in the workforce. Recently, the labour participation rate of older people (aged 55-64 years) has risen spectacularly. This, too, is primarily due to the increased labour participation of women, though attempts to address the problems surrounding the state retirement pension (AOW) and the abolition of early retirement schemes (VUT) have also contributed.

Chart 1.6 - Labour participation rate in the Netherlands and EU-15

As a percentage of the potential labour force

Source: OECD.
The scope for a further increase in the labour participation rate is decreasing, but improvements are still certainly feasible. First, the government’s planned cuts in the duration of unemployment benefit will help restrict long-term unemployment. Second, more older people can be kept in work, even beyond their official retirement date. And third, the participation of people with an employment disability can be boosted by plans to reform the provision for young disabled persons (Wajong) and the sheltered employment provisions.

The annual number of hours worked per person has fallen steadily in the Netherlands over recent decades, from nearly 1,900 hours in 1970 to just below 1,400 in 2012. The main reason for this is that women who began working during that period predominantly took part-time jobs. At present, 62% of women in the Netherlands work part-time, compared with 18% of men. The average figures in the OECD are much lower, at 25% and 8%, respectively. Rising real incomes may be leading to a higher proportion of the labour force opting for more free time. However, an undesirable situation arises when employees would like to work more hours but choose not to because it hardly pays to do so. For example, lower childcare allowance means that working an extra hour produces less and less benefit for some employees. The government therefore needs to stick closely to the credo that ‘working more must pay’. The Van Dijkhuizen Committee has made a number of very welcome recommendations in this regard, such as reducing income tax rates combined with a broadening of the tax base and streamlining of the allowances system.

Still, the structural contribution of the above factors to growth is limited, so economic growth will have to come mainly from increases in labour productivity. The drivers are complex. First, it is important that businesses invest in their capital goods stocks, because many productivity-raising innovations are incorporated in capital goods. However, since the end of the 1980s, the investment ratio of Dutch businesses has been on a downward trend (see Chart 1.7). It is important to identify the factors underlying this downturn. As discussed earlier, it is in any event crucial that lending facilitates profitable investment.

Human capital also has an important role to play. The knowledge production of a small country like the Netherlands is, by definition, relatively low. The ability to absorb knowledge and innovations from elsewhere is therefore vital. Crucial elements for achieving this are reading and numerical skills, a command of

**Chart 1.7 - Trend in investment ratio of Dutch businesses**

*As a percentage of value added of the business sector*

![Chart 1.7 - Trend in investment ratio of Dutch businesses](chart.png)
Interdependence of growth and financial stability

English, access to ICT and problem-solving ability. Fortunately, the quality of the human capital in the Netherlands is adequate. Dutch educational outcomes are relatively good, while spending on education is around the EU average. English is widespread in the Netherlands, and recent research by the OECD suggests that the professional skills that are likely to be important in the coming decades for growth and innovation are at a very high level in the Netherlands (see Table 1.1). This applies to both reading and numerical skills as well as the ability to solve problems in a technical environment. These outcomes are the fruits of systematic investments in the Dutch labour force. Investments in knowledge will continue to be very important in the future, especially investments in the quality of teachers and in pre-school education aimed at eliminating language deficiency.

The Netherlands must also continue working to develop labour market institutions that support productivity growth. One example is the dismissal system: the present rules impede the dynamic of the labour market, especially in the case of older workers in long-term employment. This can hamper labour productivity growth. The government plans for a new dismissal system more closely align the rights of different workers and are therefore a step in the right direction.

1.3 **Macroprudential policy contributes to a strong financial system**

One of DNB’s tasks is to promote financial stability. To this end, DNB acquired new macroprudential instruments in 2014, which can be used to increase the financial system’s resilience to shocks and combat vulnerabilities.

1.3.1 *Promoting financial stability: a formal task from 2014*

A stable financial system is a key condition for strong, sustainable economic growth. Financial institutions and markets play a crucial role in financing investments and spreading risks. Many recent national and international reforms in the financial sector are intended to ensure that the financial system can continue fulfilling this role, even in the face of economic or financial shocks. These reforms are also intended to prevent the financial system itself from becoming a source of risk.

The new European supervisory regulations for banks incorporate macroprudential policy instruments that can be deployed to promote the solidity of the financial sector (see Box 1.2). The Member States take the lead in the use of these instruments, reflecting the fact that vulnerabilities are often national in nature.

### Table 1.1 - Professional skills in international perspective

<table>
<thead>
<tr>
<th>Skill</th>
<th>Score</th>
<th>Top 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numerical skills</td>
<td>4</td>
<td>Japan, Finland, Sweden</td>
</tr>
<tr>
<td>– youngest cohort</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reading skills</td>
<td>3</td>
<td>Japan, Finland, The Netherlands</td>
</tr>
<tr>
<td>– youngest cohort</td>
<td>3</td>
<td>Japan, Finland, The Netherlands</td>
</tr>
<tr>
<td>Problem-solving ability</td>
<td>3</td>
<td>Sweden, Finland, The Netherlands</td>
</tr>
<tr>
<td>– youngest cohort</td>
<td>4</td>
<td>South Korea, Finland, Sweden</td>
</tr>
</tbody>
</table>

Note: Score refers to the ranking of the average test score of the Dutch participants in comparison with 23 OECD countries.
Source: OECD.
Interdependence of growth and financial stability

This is also a priority for DNB. It is therefore important that promoting financial stability is embedded in the Bank Act and the Financial Supervision Act (Wet op het financieel toezicht – Wft) as a formal DNB task from 1 January 2014. This offers DNB a broader statutory basis to make an active contribution to a strong financial system. The new European legislation allows DNB to take measures to increase the resilience of banks to shocks if it identifies risks for the financial system as a whole.

1.3.2 Macroprudential policy aims and instruments

Macroprudential policy is an important tool for promoting financial stability. The emphasis in this policy lies on enhancing the resilience of the financial sector by identifying and countering systemic risks, for example through higher capital buffers and curtailing the interdependence of financial institutions. Macroprudential instruments are targeted primarily at ensuring that the financial system can better withstand threats. This is generally a more realistic aim than preventing or eliminating threats, which DNB often has virtually no ability to influence. Financial developments are strongly driven by global factors, including capital market interest rates and financial market sentiment. Moreover, stability risks are often characterised by great uncertainty, which means they are recognised too late or not at all and cannot be mitigated through advance measures.

One of the macroprudential instruments is the countercyclical capital buffer (CCB), which impacts lending. Banks are required to build up an additional capital buffer in times of relatively high credit growth. If a crisis breaks out, this buffer can be released, so banks can use it to absorb losses. Other instruments target specific systemic risks, such as mortgages or commercial property exposures, or specific characteristics of banks. For example, banks that are classed as systemically important are required to hold additional capital. Box 1.3 considers the operation of two macroprudential instruments in more detail.

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Box 1.2 Overview of macroprudential instruments

*European regulations for banks*
- Extra capital buffer for systemically important banks
- Extra capital buffer for non-cyclical systemic risks
- Countercyclical capital buffer in times of rapid credit growth
- Stricter risk weights for property exposures
- Extra prudential requirements for groups of institutions with a comparable risk profile (Pillar 2)
- Stricter national requirements in several areas (‘flexibility package’):
  - Capital and reserves
  - Large items
  - Liquidity
  - Exposures to specific sectors: property and financial institutions

*National regulations*
- Loan-to-income (LTI) limits on residential mortgages
- Loan-to-value (LTV) limits on residential mortgages
Box 1.3 Macroprudential instruments in practice: two examples

Example 1: countercyclical capital buffer (CCB)

Instrument: capital surcharge of up to 2.5% of the risk-weighted assets, or possibly higher.

Purpose: to protect banks against macro-risks.

Intermediate goal: to counter the risks of excessive credit growth.

Indicator: a credit-to-GDP ratio that deviates from the long-term trend.

Transparency:
- publication of the credit-to-GDP indicator, possibly other indicators and an explanatory analysis;
- establishment of buffers in accordance with guidelines being developed by the European Systemic Risk Board (ESRB).

Procedure:
DNB decides each quarter whether to activate or adjust the CCB, partly on the basis of the above indicators. If the CCB has been activated, DNB can decide to increase the buffer, reduce it or – during a crisis – release it so that banks can use it to absorb losses. Foreign banks are also required to build a CCB buffer of up to 2.5% as imposed by DNB for loans in the Netherlands. This maintains the level playing field between domestic and foreign banks.

Countries are free to use additional indicators alongside the credit-to-GDP ratio. Earlier crises have, for example, shown that the build-up of imbalances is often accompanied by strongly rising property prices. Countries that have currently activated the CCB – Switzerland and Norway – substantiate this with different indicators in addition to the credit-GDP ratio.

Example 2: macroprudential instruments targeting real estate

Instrument: risk weights for property, Loan-to-Value (LTV) and Loan-to-Income (LTI) limits.

Purpose: to protect banks and consumers against the risks of a housing market crisis.

Intermediate goal: to counter the risks of excessive credit growth in the property sector.

Indicator: lending to households in combination with a rise in nominal house prices, investments in property (as % of GDP).

Transparency: publication of the indicators used and any signal values.

Procedure:
If indicators suggest a credit-driven property bubble, DNB must assess whether instruments need to be deployed, and if so which instrument is most appropriate. DNB can adjust the risk weights, which are mainly effective in increasing banks’ resilience to shocks.
1.3.3 How does DNB use the macroprudential instruments?

Macroprudential instruments are linked to intermediate goals. These can be made more tangible than the ultimate risks and are therefore useful for operationalising policy aimed at financial stability. An example of an intermediate goal is countering excessive credit growth; this goal can be linked to instruments such as the countercyclical capital buffer (CCB) and LTV limits. Another example is countering perverse incentives for financial institutions. This intermediate goal can be linked to a capital surcharge for systemically important banks and an obligation to disclose certain risks. Intermediate goals often stem from market failures and are therefore a reason for intervention in themselves. They are also often essential links through which vulnerabilities can spread during a crisis.

An acceleration of credit growth systematically emerges as a key indicator of a build-up of imbalances. This also applies to the Netherlands, where there is a clear relationship between rising house prices and developments in the commercial property market (Chart 1.8). There are intervals of more than twenty years between successive peaks and troughs, corresponding to the length of the financial cycle. DNB will therefore partly base any decision on whether or not to deploy macroprudential instruments on these indicators. Macroeconomic variables such as economic growth, unemployment and inflation are generally only moderately useful as indicators of macroprudential risks. These variables mainly reflect the economic cycle, which is much shorter, on average, than the financial cycle.

Although Member States take the lead in macroprudential policy, coordination at European level is often desirable. This enables cross-border effects to be taken into account. It is important in this context that countries acknowledge each

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**Chart 1.8 - Macroprudential indicators for the Netherlands**

Deviation from trend in percentage points and moving three-year averages in percentage changes

<table>
<thead>
<tr>
<th>Deviation from trend in credit-to-GDP ratio (right-hand scale)</th>
<th>House prices</th>
<th>Commercial property</th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>30</td>
<td>20</td>
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<tr>
<td>30</td>
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<td>15</td>
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<td>-10</td>
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<tr>
<td>-20</td>
<td>-10</td>
<td>-10</td>
</tr>
</tbody>
</table>

Note: Deviation from trend in credit-to-GDP ratio is calculated on the basis of a Hodrick-Prescott filter, with a relatively rigid trend.

Source: Statistics Netherlands and DNB.
other's measures and apply them to cross-border lending by their own banks. This reciprocity is actually mandatory for the CCB (see Box 1.3). Within the banking union, the ECB can also apply stricter macroprudential measures that target banks. This builds in incentives to take timely action at both national and European level, and helps counter inaction bias: the inherent tendency to defer necessary measures when a crisis seems a long way off.

### 1.3.4 Rules, discretion and transparency

Macroprudential policy can be linked to indicators in a predetermined way. This offsets the inaction bias referred to above and makes the policy transparent and predictable. It also facilitates the preparation of policy measures, thereby increasing their effectiveness. On the other hand, discretionary decision-making offers scope to respond to developments that are not captured by the indicators, such as in the case of financial innovations. In light of this, decision-making based on limited discretion, in which the authority combines its own view with fixed principles and indicators, appears to offer the most suitable framework for macroprudential policy. Where possible, the authority can use quantitative signal values as indicators; it may for example explicitly commit to taking a decision about the use of an instrument if one or more indicators reach certain signal values.

Financial stability is a difficult concept to measure, and the accountability of the authority is therefore heavily dependent on transparency about the policy pursued. This can be achieved through communication about the policy framework used, the risks identified and the measures taken. DNB has put this into practice in recent years through the regular publication of the Overview of Financial Stability (OFS) and ad hoc publications on specific themes. In the future, these publications will devote more explicit attention to the way DNB fulfils its tasks in respect of financial stability. They will consider matters such as deviations from the credit growth trend, developments in asset prices and interdependencies between financial institutions. At least twice a year, DNB will provide information on the main systemic risks and the instruments used to map these risks.

### 1.4 How the EMU is recovering from the debt crisis

Following the announcement of the OMT programme and the launch of the banking union, calm has largely been restored to the financial markets in the currency union. However, sustainable calm requires a further reduction in the macroeconomic imbalances within the EMU. Important progress has been made in this area, but a great deal remains to be done. The challenge is to continue along this path now that the pressure in the financial markets is easing.

#### 1.4.1 Debt crisis in a new phase

The ECB announced its OMT programme in September 2012, partly in response to the doubts that had arisen in financial markets about the irreversibility of the euro – doubts that were dismissed at the time as ‘unfounded’ by ECB president Mario Draghi. During that same period, European government leaders put an end to the latent uncertainty about Greece’s future as a member of the EMU and decided to create a banking union. Since then, major strides have been made in a short space of time, which would have been unimaginable until recently. For example, Europe has developed and adopted legislation on common banking supervision in the euro area and a single resolution mechanism for
banks (see Section 2.2). Following a comprehensive assessment of bank balance sheets, the ECB will assume overall responsibility for banking supervision in the EMU at the end of 2014. Equally important is the rapid establishment of macroprudential authorities in many Member States and the ability to coordinate this policy at European level. In the meantime, many countries have also made major progress in the areas of fiscal consolidation and structural reforms.

All these developments have taken the debt crisis into a new phase. Although the changes have seriously impacted economic growth in the short term, they will ultimately help to prevent the kind of long-term economic stagnation that occurred following the financial crisis in Japan in the 1990s. At the same time, a great deal still remains to be done and the improved situation in the financial markets must not be allowed to lead to ‘reform fatigue’ or a watering down of the existing reform agendas.

1.4.2 Calm largely restored in EMU financial markets

Partly thanks to the ECB intervention, the stress in the euro area financial markets has eased considerably. The ECB has provided liquidity to banks with a term of up to three years, thus assuring their funding for an extended period. By launching the OMT programme, the ECB has also enabled the support buying of government bonds, on the condition that countries that receive support stick to an economic reform plan. The OMT programme has not yet been activated, but thanks to its signal function, yields on government bonds issued by vulnerable countries in the euro area have fallen substantially. The decline has been greatest in Greece, Portugal and Ireland, but capital market interest rates are also substantially lower in Spain and Italy. Ireland recently ended the emergency financial assistance programme and the Irish government is once again able to raise finance independently. The Spanish support programme for the financial sector has also come to an end, while the programmes for Portugal and Cyprus are running to schedule.

The damaging capital outflow from the vulnerable countries to the core countries of the euro area has meanwhile been reversed (see Chart 1.9). As a result, the funding conditions in the vulnerable countries have greatly improved, and their banks are regaining access to market funds, making them less dependent on finance from the Eurosystem. This is reflected in a decline of more than a third in the balances in the TARGET2 payment system and the partial repayments on long-term loans from the ECB.

However, the financial conditions still diverge across the euro area countries – though complete equivalence in financial conditions is not an end in itself. Since the financial crisis, the financial markets have been paying more attention to risks, and with good reason. Differences in economic fundamentals, such as the relative size of the public debt, mean that capital market interest rates continue to diverge across different countries. And the funding conditions for banks still depend on the quality of their assets. Monetary policy cannot eliminate these risks, but can buy time for the necessary fundamental reforms and ensure that the financial markets continue to function properly when assessing these risks.
1.4.3 Reduction in macroeconomic imbalances

The relative calm in the financial markets during the past year can only be sustained if Member States further reduce the macroeconomic imbalances that built up before the crisis. There are clear positive developments in this regard, but they have exacted a high price in terms of economic growth and unemployment.

The competitiveness of vulnerable countries is clearly improving. Unit labour costs in Spain, Portugal, Ireland and Greece (see Chart 1.10) have fallen substantially over the last few years, enabling these countries to recapture some of the lost ground in terms of competitiveness since the launch of EMU.

In some countries, however, the changes have partly been achieved at the expense of an exceptionally sharp fall in employment. Alongside the economic component, this sharp drop also reflects the need to reform the sector structure. Initially, employment shrank in domestically oriented sectors, such as construction, which had grown too large. In recent quarters, pay moderation has made a major contribution to the correction in unit labour costs, making the improvement more sustainable. However, the improvement in labour costs is not yet translating into lower sales prices everywhere. This is probably due to lack of competition in product and service markets, for example as a result of regulations that restrict competition or administrative barriers to start-up businesses.

Balance sheet repair in the private and public sectors is also slowly but surely taking hold (see Chart 1.11). Savings in the private sector in particular have increased sharply since the crisis, as borne out by the higher net budget balances. In addition, progress has been made in reducing budget deficits. In most cases, this has not yet led to a reduction in debt ratios in the public sector, partly because nominal GDP has fallen as a result of the recession. By contrast, private debt has reached a turning point in most countries, and is already falling markedly in Spain and Ireland. Despite these positive developments, it is likely
The increase in savings and improvement in competitiveness have also brought more equilibrium to the balances of payments in the euro area. The current account deficits in vulnerable Member States have reduced sharply and have in some cases been turned into a small surplus (see Chart 1.12). The German current account surplus relative to the other EMU countries has also declined: this specific trade surplus fell from over 2.5% of GDP in 2008 to a roughly balanced position in 2013. In this way, Germany is contributing to the restoration of balance-of-payments equilibrium within the EMU.

The improvement in the current account balances of the vulnerable Member States is partly due to a sharp decline in imports as a result of the (deep) recession these countries were in until recently. Some of the improvement is therefore likely to be lost again once economic growth picks up further. However, this fall in imports also has a long-term component, as demand in these countries is likely to remain depressed for some time, given the need for further strengthening of balance sheets in the public and private sectors. The current account balances of Spain, Portugal and Greece, in particular, have also been helped for a number of quarters by a distinct improvement in export growth.

1.4.4 Structural reforms implemented

Clear progress has been made in the area of structural reforms. These reforms are needed in order to increase the growth potential, make it easier to adjust wages and prices, and facilitate the process of balance sheet repair. Vulnerable
Member States have implemented many reforms in recent years, especially those under a support programme (Greece, Ireland, Portugal and Spain). However, the pace of reform in large EMU countries such as Italy and France leaves something to be desired; evidently reforms stand the greatest chance of success when there is heavy pressure from the financial markets or conditions are attached to reform programmes.

The reforms have thus far been strongly focused on the labour market. For example, the wage formation framework has been radically reformed in all Southern Member States by expanding the scope for decentralised wage negotiations. In Spain and Greece, decentralised agreements now even take precedence over sector-wide collective labour agreements. Some Southern Member States have also taken additional measures, such as curbing the automatic continuation of clauses from lapsed collective labour agreements (such as pay increases) if no new agreement has been signed. Another example is raising the minimum number of employees and employers that must be represented by the relevant trade unions and employers’ organisations before a collective labour agreement can be declared generally binding. In addition, the minimum wage has been tackled; Portugal and, at a later stage, Spain froze their minimum wages, which have actually been drastically reduced in Greece.

Employment protection in the Southern Member States has also been relaxed, which in principle has increased the demand for labour while fostering its efficient allocation. One caveat here is that, in practice, it is not only the statutory employment protection that is important, but also its interpretation by the courts and the efficiency of the judicial process in case of dismissal. This means that the effectiveness of these reforms only becomes apparent after some time. Moreover, in most of these countries there is a significant difference...
Interdependence of growth and financial stability

in employment protection between temporary and permanent employment contracts, which hinders the movement from temporary to permanent employment. This affects young people in particular. A further relaxation of the employment protection in permanent employment contracts therefore remains a priority. In fact, the same applies to most of the core countries as well.

Compared with the labour markets, much less progress has been made in improving the functioning of product and service markets, though most vulnerable countries have taken some steps in this regard. Still, these reforms are vital for increasing economic growth potential. In the case of fierce competition in product and service markets, pay moderation leads to lower prices and not just to a redistribution from labour to capital. There is still undesirable rigidity in this area in the core countries, too, especially in the service markets. This discourages investment and consequently depresses domestic demand. Greater efforts are needed on this front, both in the core Member States and in the periphery. Rigorous implementation of the EU Services Directive is therefore a priority. The smooth functioning of the product and service markets also requires the resolution of institutional deficiencies, which act as informal access barriers. The Global Competitiveness Report 2013-2014, for example, points out that an inefficient judicial process is a problem in the Southern Member States and that companies in most Member States are weighed down by excessive regulation. On the other hand, positive developments are also visible in this area; Portugal and Italy, for example, are currently reforming their legal system.
1.4.5 Staying on course

The biggest challenge in the coming period is for Member States to stick to the course on which they embarked. The improved financial conditions and the signs of a fragile recovery in confidence have come about largely thanks to the earlier intervention of governments and central banks. Only by continuing along the present path will it be possible to make the recovery of the euro area more future-proof and open the way for sustainable growth.

This firstly requires that Member States themselves continue the efforts they have made thus far. At European level, it is key to continue encouraging these necessary adjustments as much as possible. The renewed European policy framework must therefore be utilised to its full potential. Europe has tightened up the fiscal rules in recent years and agreed new rules to deal with macro-economic imbalances (the Macroeconomic Imbalance Procedure - MIP). Experiences with this framework are still new, but its application could be improved by defining criteria more clearly and applying them more uniformly, focusing policy recommendations more on the principal problems facing countries and devoting more attention to the implementation of recommendations.

In 2014, there will be further discussions in Europe about the possibility for Member States to make mutual contractual agreements to implement reforms, possibly in exchange for support from a European solidarity mechanism. However, expectations should not run too high: contracts could slightly increase the incentives to reform, but the important role given to the Council of Ministers rather than the Commission adds to the risk that Member States will water down recommendations or not implement them at all. It would be better if Europe were to strengthen the enforceability of good fiscal and structural policies in other ways. Greater enforceability is sometimes seen as an undesirable constraint on national policy freedom. However, that greater enforceability offers protection against an even greater loss of policy freedom if the imbalances in EMU countries become too great and they are forced to institute reforms by pressure from the financial markets. Preventing imbalances is always cheaper than correcting them, partly because financial markets react strongly, and sometimes overreact. If further mutual agreements are able to prevent those imbalances, all EMU countries stand to benefit. This includes countries that are already pursuing sound policies, since they will themselves be less affected by the further agreements and unsustainable developments in the rest of the euro area. The same certainly applies to the Netherlands, which, given its relatively open economy, large financial sector and sizeable pension assets, is sensitive to financial shocks in other countries.

A first option for increasing the enforceability of sound policies is to enforce the existing rules more strictly and in a more politically impartial way. One way of doing this would be to further strengthen the role of the European Commission, particularly in the MIP. It would also be helpful if the Council of Ministers were to vote in more stages of the existing procedures via a reverse qualified majority. This would make it more difficult for the Council to reject or water down Commission proposals.
1.5 **Risks of and exit from unconventional monetary policy**

The ECB’s expansive unconventional monetary policy measures have improved market conditions and eased monetary transmission bottlenecks. The challenge is to prevent negative side effects through appropriate design and a timely exit from these measures. This demands careful communication by central banks. The refinancing measures in the euro area have been structured in such a way that an exit from the unconventional monetary policy will, in part, be an automatic process.

1.5.1 **Consequences of unconventional monetary policy**

Conventional policy in the form of cutting policy rates proved insufficient to stabilise the international economy. A wide range of unconventional monetary measures was therefore implemented, leading to strong growth in central bank balance sheets (see Chart 1.13). One of the main measures taken by the ECB involved significantly stepping up the provision of liquidity to banks in order to overcome the bottlenecks in monetary transmission. To achieve this, banks were granted almost unlimited liquidity in normal and very long-term refinancing operations (VLTROs). The ECB also relaxed the collateral requirements for providing this liquidity in order to resolve the shortage of collateral at peripheral banks in particular, and to ensure the provision of sufficient liquidity. The OMT programme announced in mid-2012 also enables the ECB to buy government bonds if the bond markets get into difficulties, provided the government of the issuing country meets certain conditions and implements an economic reform programme. The Federal Reserve (Fed) and the Bank of England (BoE) expanded their monetary policies by lowering capital market interest rates through non-sterilised purchases of securities. And since last year, the Bank of Japan (BoJ) has been explicitly striving to achieve an inflation rate of 2% by aggressively buying securities. Central banks also influence the money market curve by issuing forward guidance on policy rates.

The unconventional policy had a considerable impact on the financial markets. The liquidity support by central banks led to reductions in both money market

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**Chart 1.13 - Central bank balance sheets**

*As a percentage of GDP*

Source: Thomson Financial.
Interdependence of growth and financial stability

rates and lending rates. The bond-buying programmes of the Fed and the BoE reduced capital market rates and risk premiums by tens of basis points, and sometimes more than 100 basis points. The improvement in market conditions had a (limited) positive impact on economic growth in the short term. The Fed’s forward guidance led to a flattening of the yield curve, while the ECB’s forward guidance reduced the volatility of money market rates. In the euro area, the announcement of the OMT programme prompted a reduction in the risk premiums that had been priced in for the break-up of monetary union. This narrowed the divergence between financial developments in the banking landscape and in the capital markets within the euro area, enabling the monetary transmission channel to function better. However, as illustrated by Chart 1.14, several financial indicators for the euro area countries still diverge more than before the crisis. This is partly due to structural factors that cannot be resolved by the central banks.

1.5.2 Unconventional policy carries risks

In addition to the advantages, unconventional monetary policy also carries risks, which stem from the unintended side-effects of the policy. These risks can be divided into four categories.

• Reduced market discipline. The lower interest rates reduce the pressure on banks to address balance sheet problems and write off bad loans. That could lead to a misallocation of credit. The generous provision of liquidity by the ECB reduces incentives for banks to raise market funding, potentially leaving them dependent on central bank funding. It also perpetuates the fragmentation of the interbank

Chart 1.14 - Divergence of financial indicators between euro countries before and after the crisis

Median of absolute deviation

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<thead>
<tr>
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<tr>
<td>TARGET2 balance</td>
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<tr>
<td>10-year government bond yields</td>
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<tr>
<td>Bank CDS spreads</td>
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<td></td>
<td></td>
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<tr>
<td>Loan interest, non-financial businesses</td>
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<td></td>
<td></td>
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<tr>
<td>Loan interest, households</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit interest</td>
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Note: The chart shows the degree of financial fragmentation in the euro area based on six indicators that relate to different segments of the monetary transmission system. For each indicator, the median of the absolute deviation has been calculated for the value of that indicator in each country. This measure of mutual differences is less sensitive to outliers than the standard deviation. To show the development of the fragmentation, the average median of the absolute deviation is calculated for three different periods: the pre-crisis years (2004-2007) as benchmark; the period of sharply rising financial stress in the months leading up to the announcement of the OMT; and the second half of 2013.

Source: Thomson Financial and ECB.
money market in the euro area. And while the unconventional policy supports the impact of conventional policy on the economy, it cannot resolve the underlying structural problems in the economy and the financial system. All an expansive monetary policy does is allow central banks to buy time to find solutions; attaching conditions to further support from the central bank may be instrumental in forcing governments and banks to implement structural reforms.

- **Price stability risks.** Central banks are loosening monetary policy reins partly because of the global trend of falling inflation. However, the ample liquidity that central banks have created through their unconventional measures poses an upside inflation risk in the longer term — and all the more so if the unwinding of the monetary stimulus is initiated (too) late. The ample liquidity can also fuel excessive rises in asset prices (equities and property). When asset market bubbles subsequently burst, this gives rise to financial stability and deflation risks. The challenge for central banks is thus to recognise these risks in time and take steps to adjust their policies early enough. The main priority here is price stability in the medium term.

- **Dependence on governments.** With the large exposures central banks have built up to their governments, the dividing line between monetary and fiscal policy has narrowed. This is partly due to the provision of liquidity to banks. As banks have used this cash to buy bonds issued by their own government, they have become more dependent on that government’s creditworthiness. Meanwhile, this also undermines the independence of central banks and increases the risk of monetary financing. These risks of unconventional policy must be contained by keeping monetary policy within the limits of the EU treaty, which prohibits the monetary financing of governments.

- **Financial imbalances.** Unconventional monetary policy can lead to renewed excessive risk-seeking behaviour by market operators. As the relative prices change, unconventional policy encourages market operators to invest in riskier assets in search of higher returns. This is actually the intention initially, but it can lead to asset price bubbles if the search for yield goes too far. The abundant liquidity in the system may find its way to emerging markets, for example, which then become more sensitive to the phasing out of the expansive (US) monetary policy. Macroprudential measures can be deployed to enhance institutions’ financial resilience to possible market corrections (see Section 1.3).

### 1.5.3 Normalisation of monetary policy

Given the risks of unconventional monetary policy described above, monetary policy will at some point have to be normalised. One condition for this normalisation is that the economy and the banking sector must have recovered from the crisis sufficiently and convincingly. For the time being, that recovery appears to be more pronounced in countries such as the United States and the United Kingdom than in the euro area. When phasing out the unconventional measures, a number of other important factors will also have to be taken into account.

During any exit, a distinction must be made between conventional measures (policy rates and forward guidance) and unconventional measures (VLTROs, full allotment of liquidity requests and expansion of the collateral framework). When the economy starts to recover and risks to price stability increase, the monetary policy reins will have to be tightened. As the health of the financial sector improves and bottlenecks in the transmission mechanism reduce, the measures taken to increase liquidity can be scaled back and the list of assets
eligible for collateral can be shortened. How unconventional measures are phased out depends partly on the instruments used. In the event of a recovery in interbank activity and funding markets, the need for precautionary liquidity will reduce, banks will make repayments on the long-term refinancing operations and the liquidity surplus will shrink. To some extent, the design of the VLTROs thus provides for a gradual and automatic exit from unconventional policy in the euro area. This will make the exit, and communication about the process, easier. However, the policy of full allotment of central bank funding and the enlarged collateral framework require an active exit, in which decisions will have to be taken on which assets are no longer eligible.

The timing of the exit will be determined by the inflationary outlook and the progress made in resolving the bottlenecks in the transmission mechanism. There is uncertainty about this, especially in the euro area, because the economic recovery is still fragile and the euro area is experiencing a period of low inflation, which is below the ECB’s price stability target. The solidity of the financial system will not be completely certain until the comprehensive assessment of bank balance sheets has been completed (see Section 2.2.1). A premature exit could harm the recovery, while delaying the exit too long could trigger new financial imbalances. If monetary policy remains too loose for too long, the risks described above will become more and more manifest. The interaction between the real and financial spheres limits the ECB’s room for manoeuvre. For example, a premature tightening of monetary policy could hurt bank balance sheets to such a degree that financial stability is jeopardised once again. The creation of the banking union will increase the room for manoeuvre, because it will contribute to a more robust banking sector.

It is also important that the exit is implemented gradually. A number of indicators will be used to determine the pace. As the conditions that count as ‘normal’ after the crisis are different from those before the crisis, some traditional indicators are less reliable for signposting the appropriate exit route. There is, for example, a great deal of uncertainty surrounding the potential growth of the economy and the level of the neutral rate of interest. A gradual exit will support the recovery of market operation and allow close monitoring of the effects.

Apart from the speed of the exit, the conditions that are regarded as ‘normal’ after the crisis will also dictate the way in which monetary policy is implemented. It is unclear whether there will be a complete return to the pre-crisis framework. The crisis and (pending) changes in financial regulations in relation to capital and liquidity requirements influence the functioning of banks and markets, and therefore monetary transmission as well. For example, the shift from trading activity to the secured money market begs the question of whether monetary policy should still focus on interest rates in the unsecured money market. It may be that such developments demand changes to the monetary toolkit, and experiences with new instruments – gained during the crisis – can then be useful. Moreover, the ECB also appears to be focusing increasingly on financial stability, and is using new macroprudential instruments for this purpose. This, too, has implications for monetary policy, because macroprudential measures also affect the monetary transmission channels through their impact on financial institutions and markets.

Exit-related risks can be mitigated by preparing the markets in time. An important element in that preparation is a proper communication strategy. This can help limit the volatility of the financial markets once the expansive measures have been scaled back.
Supervision: work in progress
2 Supervision: work in progress

2.1 Introduction

The financial sector is going through a major transition in response to the financial crisis. More than five years after its onset, the end of this process is coming into view. Banks are making good progress with the transition in several respects, including the strengthening of their buffers and the scaling back of their high-risk activities. The consequences of the crisis have also prompted extensive changes in supervision. The initial results are becoming apparent but implementation is still in full swing.

This chapter uses selected cases to outline the status of the principal challenges in supervision. The focus is specifically on developments that will take place in the coming years and to a lesser extent on the supervisory activities in the reporting year. A detailed review and account of the supervisory activities carried out by DNB in 2013 is given in the 2013 independent public body (ZBO) report, which is published simultaneously with this Annual Report.

Section 2.2 describes developments in relation to the European banking union. As part of the Single Supervisory Mechanism (SSM), from 4 November 2014 the ECB will assume the ultimate responsibility for prudential banking supervision in the euro area. The resolution of failing banks and the provision of safety nets will also be handled at supranational level within the banking union, through the Single Resolution Mechanism (SRM) and the Single Resolution Fund (SRF). However, a good deal of work remains to be done before November.

Section 2.3 explores changes in the supervisory frameworks for banks, insurers and pension funds. Dutch banks must be fully compliant with Basel III and the related European regulations by 2019. Solvency II is approaching for Dutch insurers, while the theoretical solvency criterion (TSC) has been implemented at national level. Work will also continue in the year ahead on the development of a new financial assessment framework (financieel toetsingskader – FTK) for Dutch pension funds.

Section 2.4 discusses developments in prudential supervision, including integrity supervision, the quality of supervision and its measurement. The events surrounding SNS Property Finance and the fixing of Libor rates further underscored the importance of integrity supervision. Strengthening the position of integrity supervision is also one of the four key recommendations in the new DNB Supervisory Strategy 2014-2018. Measuring the impact of supervision has also become more important. In response, DNB has developed a set of Key Performance Indicators (KPIs) for its supervisory ambitions formulated in 2012. The first measurement was carried out in 2012, and the measurement and
reporting process was fine-tuned in 2013 (for the results, see the 2013 ZBO report). With a view to the accountability and continual improvement of supervision, DNB will further embed these ambitions and KPIs in its supervisory practice in the year ahead.

2.2 European banking union

2.2.1 European banking supervision

DNB has been calling for supranational banking supervision for many years. The SSM will help break through the negative interaction between Member States and the national banking system. Supranational supervision is more consistent with the international nature of the banking sector in general, and the Dutch banking sector in particular. From 4 November 2014, the ECB will assume ultimate responsibility for prudential banking supervision in the euro area. In preparation, the ECB is recruiting approximately 800 supervisors, who will work closely with their national colleagues, including those at DNB. However, the SSM is not a cost-saving exercise; in fact, banking supervision is set to become more expensive. Ensuring an orderly transition to the SSM is a top priority for DNB in 2014.

The SSM will bring supranational banking supervision to Europe, an institutional improvement that DNB has supported for many years. The banking union not only embraces supervision, but also introduces supranational resolution of failing banks through the Single Resolution Mechanism (SRM) and the creation of safety nets via the Single Resolution Fund (SRF). The SSM will become operational on 4 November 2014. Its geographical scope primarily concerns the euro area, though Member States outside the euro area can also participate. The most recent signals from Brussels suggest that the resolution pillar of the banking union, the SRM, will likely come into effect shortly after the SSM. This is welcome news, as an effective banking union needs, as a minimum, to incorporate both supervision and resolution. If supervision is organised supranationally but resolution is left at national level, conflicts of interest can arise and undermine the effectiveness of the supervision. It would mean, for example, that a supervisory decision to resolve a bank would be taken at central level, whereas the bill resulting from such a decision would have to be paid at national level. Simultaneously introducing the two pillars, in so far as possible, will also reduce the risks for the taxpayer as early intervention through the SRM avoids the need to address European funding mechanisms. The third and final pillar of the banking union is a European deposit guarantee scheme (DGS). Apart from a further harmonisation of national deposit guarantee schemes, there are currently no concrete proposals on the table for a European DGS, nor are they expected in the short term.

The primary purpose of the banking union is to break through the negative interaction between Member States and their national banks. Several Member States got into serious difficulties during the crisis because of problems with their national banking sectors, and vice versa. These national dynamics will be broken by centralising the supervision and resolution (including funding) of banks. The banking union will also contribute towards a more level playing field for the banking sector: banking supervision will become more uniform, with less scope for national options and decisions. This will help boost market confidence in the European banking system.
The SSM is not a ‘solo effort’ by the ECB, but involves close cooperation between the ECB and the National Competent Authorities (NCAs). However, the ECB does take the lead in the SSM, which is in line with its overall responsibility for the prudential banking supervision of all banks in the euro area. Financial supervision tasks other than the prudential supervision of banks fall outside the mandate of the SSM and will continue to be organised at national level. Examples of these include conduct supervision, integrity supervision and prudential supervision of pension funds and insurers.

The SSM distinguishes between significant and less significant banks. Whether or not a bank or banking group is classified as significant depends among other things on the total value of its assets (threshold value: EUR 30 billion) and its importance for the local economy (threshold balance sheet values: EUR 5 billion and 26% of GDP), and in any event includes, the three largest banks in each participating Member State. In addition, the ECB will exercise direct supervision of banks that receive or have received direct support from the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM). Of the total of more than 3,000 banks in the euro area, 124 are currently identified as significant according to the above definition (consolidated figures). This group of banks accounts for more than 85% of the consolidated bank assets in the euro area. The provisional list of significant banks includes seven Dutch institutions: ING Bank, Rabobank, ABN AMRO Bank, SNS Bank, Nederlandse Waterschapsbank, Bank Nederlandse Gemeenten and Royal Bank of Scotland NV. Together, these banks represent almost 90% of Dutch banking sector assets.

The ECB will exercise direct supervision of significant banks through Joint Supervisory Teams (JSTs). JSTs are bank-specific account teams made up of ECB and NCA employees and led by a JST coordinator from the ECB. The ECB will make available more than 400 full-time employees (FTEs), to be divided across an anticipated total of approximately 120 JSTs. The direct involvement of NCA employees in the JSTs will ensure that local knowledge and expertise are being used. The ECB will supervise less significant banks indirectly; these banks will remain under the direct supervision of the NCAs, but the ECB can at all times adjust or take over the supervision. As part of this process, NCAs will report to the ECB on their method of supervision and the decisions taken. The ECB has around 80 FTEs available for this indirect supervision.

In addition to institution-specific supervision, the SSM also provides for cross-institution supervision through a large horizontal supervision directorate incorporating functions such as quality assurance, market access, intervention & enforcement and on-site supervision. DNB also covers most of these horizontal functions, but where the SSM identifies a separate on-site supervision function, DNB has integrated this function into its account supervision. DNB has additional horizontal functions that are currently not represented in the SSM, such as ICT supervision and supervision of conduct and culture. The SSM also introduces new supervisory methods and processes. It has, for example, developed its own supervisory methodology (Risk Assessment System or RAS), which will replace DNB’s risk assessment methodology (FOCUS!) in banking supervision. The new methods will apply in all Member States participating in the SSM and to every bank.

The creation of the SSM has major consequences for DNB and the transition will be an intensive process. The largest changes will be made in banking supervision. The JSTs for significant banks will have to be staffed, while the supervision of less significant banks must also be structured in accordance with
Supervision: work in progress

SSM standards. The on-site supervision function will consequently become more separate from account supervision. DNB also faces changes outside the realm of banking supervision in such areas as the cooperation with insurance and pension supervision, financial stability (macro and micro-linkage), DNB’s internal governance and the policy cooperation between NCAs and the ECB.

The transition also involves conducting a Comprehensive Assessment (CA) of significant banks. This detailed balance sheet review has in fact already begun, also for the seven Dutch banks listed above. There are three parts to the balance sheet assessment: (1) a supervisory assessment using RAS; (2) an Asset Quality Review (AQR); and (3) a stress test carried out jointly by the European Banking Authority (EBA) and the ECB (see Figure 2.1). In order to restore confidence in the European banking sector, the Comprehensive Assessment must be sufficiently rigorous and must also be transparent in terms of process and methodology. The Comprehensive Assessment will be given a high priority during the transitional year 2014. Given the short timelines, the specific expertise required and the need for the exercise to be credible and impartial, the ECB and NCAs will be supported by external parties.

The ECB will pass on the costs of its supervisory tasks directly to the banking sector. The supervisory team will comprise approximately 800 FTEs, who will be supported by a further complement of almost 300 FTEs. Since the NCAs will retain their own budgets, the introduction of the SSM means that banks will face two supervision bills: one central and one local. The ECB is developing a methodology for this. Compared with the other euro area countries, banking supervision in the Netherlands is already fairly lean. For example, the average DNB supervisory capacity for the three largest Dutch banks is 15 FTEs per bank, five fewer than the average used by other NCAs for comparable institutions. DNB is explicitly seeking to avoid unnecessary overlap with ECB supervision. However, the SSM is not a cost-saving exercise: banking supervision is set to become more expensive.

Figure 2.1 - SSM Comprehensive Assessment

<table>
<thead>
<tr>
<th>RAS</th>
<th>AQR</th>
<th>Stress test</th>
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<tbody>
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<td></td>
<td>Phase I</td>
<td>Phase II</td>
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<td>Nov 13</td>
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<tr>
<td>Dec 13</td>
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<td>Oct 14</td>
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<tr>
<td>Nov 14</td>
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</tbody>
</table>

SSM start

RAS: analysis of main risks
AQR phase I: portfolio selection
AQR phase II: execution
AQR phase III: reporting
ST: EBA/ECB stress test, with input from AQR
2.2.2 European resolution

European banking supervision is one of the three pillars of the banking union. In addition to the European supervisor, a Single Resolution Mechanism (SRM) is also being created for the orderly resolution of failing banks. The SRM will have extensive powers. One challenge here will be to ensure that strength and competence are also embedded in the governance structure. Alongside the SRM, there will also be a Single Resolution Fund (SRF). Creating a single fund for all banks within the SRM area is an important step in breaking the interdependence between banks and national governments. It reduces the risk that public funds will be needed to rescue banks in the future. However, to eliminate this interdependence once and for all, a supranational mechanism of last resort is also needed, for instance in the form of a credit line from the European Stability Mechanism (ESM).

New instruments, such as bail-in and resolution finance, are intended to break the interdependency between national governments and banks. These instruments are designed to protect states, central banks and the banking sector itself against the financial consequences of bank failures. Bail-in is a means of writing off liabilities or converting them to shares if banks fail or are in danger of failing. It forms part of the Bank Recovery and Resolution Directive (BRRD). Resolution finance involves establishing arrangements in advance to finance the resolution of a bank. In the context of the banking union, a Single Resolution Fund (SRF) will be built up in Europe, financed by the banks, which can be brought into play for a variety of purposes such as liquidity injection or the provision of guarantees. The BRRD is expected to come into effect in 2015, bail-in no later than 2016.

The BRRD prescribes that investors must absorb losses equivalent to at least 8% of the balance sheet total via bail-in, before funding of up to a maximum of 5%
can be provided from the resolution funds. In principle, public funds will be used only after these options have been deployed. The options of bail-in and resolution finance therefore reduce the risk that public funds will be needed to rescue banks in the future. However, to completely break the interdependency between governments and banks, a publicly funded safety net totalling EUR 55 billion will be needed over and above the SRF, for example in the form of a credit line from the ESM.

**Bail-in**

The purpose of bail-in is to ensure that future bank losses are borne primarily by shareholders and creditors, before public funds are used. This has a number of key advantages. First, it limits the risks for the government. Second, bail-in eliminates the distortion of the playing field between small and large banks: because of their critical function in the economy, large banks stand to benefit more from the safety net provided by the government. Third, bank funding is no longer implicitly subsidised, but reflects the actual costs. This reduces the incentive for banks to take on excessive risks and encourages creditors to monitor banks more effectively. However, since bail-in implies that losses are borne by different parties, its application does carry contagion risks. Given these risks, it is important to know which parties are capable of holding debt paper that may be subject to a bail-in. After all, these parties run the risk of being confronted with losses if a bail-in proves necessary.

As the bail-in instrument in the BRRD currently exists only on paper and has not yet come into effect, it is not possible to determine its effectiveness or its ultimate impact on bank funding costs. However, there are indications that market operators are increasingly allowing for the possibility of losses in the event of a bank failure. In the wake of the crisis, investors no longer see bank debt as an almost risk-free investment. Before the financial crisis, investors rarely demanded a risk premium for unsecured European bank bonds; a return to that scenario is now unlikely (see Chart 2.2).

**Chart 2.2 - Risk premium for bank bonds issued in EUR**

<table>
<thead>
<tr>
<th>Subordinated bonds</th>
<th>Regular (senior) bonds</th>
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</thead>
<tbody>
<tr>
<td>15.0</td>
<td></td>
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<tr>
<td>12.5</td>
<td></td>
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<tr>
<td>10.0</td>
<td></td>
</tr>
<tr>
<td>7.5</td>
<td></td>
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<tr>
<td>5.0</td>
<td></td>
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<tr>
<td>2.5</td>
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<td>0</td>
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</table>

Risk premium is the return over and above the risk-free interest rate (five-year interest rate swap).
Source: Thomson Datastream.

58  DNB / Annual Report 2013
Notwithstanding the bail-in requirement, the BRRD allows the flexibility to exempt specific creditors. It is therefore not always clear in advance which holders of bank debt will be affected. This uncertainty could have a disproportionate impact on bank funding costs. Banks can, however, mitigate this effect by holding an explicit tranche of debt that is eligible for bail-in. Financiers can price a debt instrument more accurately if it is clear in advance that their loan will be risk-bearing if the bank gets into difficulties. So an explicit bail-in tranche boosts financial stability and enhances the effectiveness of the bail-in instrument.

Resolution finance

Only after a bail-in equivalent to at least 8% of the total liabilities has taken place can a resolution fund provide capital of up to 5% of the balance sheet total. Historically, the 8% threshold is sufficiently high to ensure that resolution finance will in most cases not be needed for loss absorption or recapitalisation (see Chart 2.3). All uncovered liabilities (with the exception of guaranteed deposits) must then be exhausted before a further contribution can be made for loss absorption or recapitalisation.

In its present form, the SRF is, in principle, not intended to protect shareholders and creditors against losses in the event of resolution. However, resolution experience shows that recapitalisation alone is often not sufficient to restore confidence in the viability of a bank, and that resolution finance is also needed in cases that cannot be financed through bail-in. For example, market operators are often unwilling to finance a bank that is going through a resolution process, which potentially creates liquidity problems for the bank. Resolution finance can resolve this by removing the uncertainty about toxic assets, for example by transferring them to a bad bank. Temporary finance or guarantees may also be extended. In addition, capital may be provided to bridge banks and bad banks, as long as this does not conflict with the rule that shareholders and creditors must bear the costs of resolution. Finally, the funding can be used to compensate creditors who are worse off due to the resolution than they would have been had the bank been allowed to fail. In the time following resolution and recapitalisation, the above measures can give the new management time to put

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**Chart 2.3 - Government support as a percentage of total assets (2008-2013)**

In percentages

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*Source: European Commission and Annual Reports*
things in order and restore confidence. Resolution finance can thus facilitate efficient resolution if a bank fails.

It is important for the effectiveness of the resolution fund and the banking union as a whole that the resolution fund is set up at European level. European resolution finance enhances the credibility of the ECB’s supervision because it involves application of the ‘he who pays the piper calls the tune’ principle. If Member States remain individually responsible for resolution finance, this could cause conflicts with European supervision. A European fund, by contrast, automatically leads to ex-ante risk sharing. This reduces the risk of suboptimum resolution due to coordination problems and ad hoc risk sharing during crises. It also reduces the tendency of national authorities to shield liquidity and capital at national level, which will benefit the allocation of capital, the operation of market forces and competition in Europe. A European resolution fund can also be smaller than the sum total of separate national funds.

2.3 Developments in the risk-based frameworks of the financial sector

2.3.1 Basel III, CRD IV/CRR
The Capital Requirements Directive and the Capital Requirements Regulation (CRD IV/CRR), which provide for the phased transposition of the Basel III Capital Accord into European directives, came into force on 1 January 2014. As a result, European banks will have to meet standards that become increasingly strict each year up to 2019. Banks strengthened their capital buffers substantially in recent years and the Dutch banking sector remains on target to meet the Basel III capital adequacy requirements in full by 2019.

The Basel capital frameworks are used as a starting point for calculating capital requirements in Europe and many other parts of the world. In Europe, these frameworks have been translated into regulations through the CRD directives. CRD IV/CRR came into effect on 1 January 2014 as part of the phased transposition of the Basel III Accord into European directives in the years to 2019.

When the very first Basel Accord (Basel I) was introduced in 1988, banks were obliged to calculate a risk-weighted capital requirement. This meant that a bank had to hold a certain minimum amount of capital, depending on how risky its assets were. For example, a bank with a high-quality mortgage book of EUR 1 billion would need to hold less capital than a bank with a EUR 1 billion portfolio of more risky commercial property loans. The underlying idea was that banks with riskier operations needed larger buffers to absorb losses. This same principle applies in Basel III, though the method used for calculating risk-weighted capital requirements has been refined and adapted over the years. The Basel I framework also introduced a minimum capital requirement of 8% and created the first global standardisation of capital requirements.

The introduction of the Basel II Accord in 2007 was an attempt to refine Basel I. The Accord introduced a three-pillar system. The Basel I capital requirements were replaced by new requirements that were placed in pillar 1. Basel II introduced the additional possibility, provided certain conditions were met, for banks to use their own internal models to calculate the capital requirements for credit, market, and interest rate risk. This means that, with the permission of its supervisor, a bank no longer needs to base the calculation of the risk-weighted capital requirement on prescribed standard risk weights, but can use its own, statistically-based models. The principal ideas here are that capital requirements
will then be more in line with the portfolios held by banks, that banks can strengthen their own risk management, and that arbitrage by the shadow banking sector will be avoided as far as possible. The second pillar of the Basel II framework comprises supplementary capital requirements. The size of this pillar 2 requirement depends on the degree to which the bank is exposed to risks that are not covered by a capital requirement under pillar 1. Examples include concentration and model risks. Stress tests are another essential instrument in determining the pillar 2 requirement. The third and final pillar in the Basel II framework consists of disclosure requirements for banks and supervisors. The idea is that disclosure enhances the quality of the information provided to market operators, thereby reinforcing the disciplinary impact of the market on the conduct of banks.

The Basel III Accord tightens up the standards of Basel II. The pillar 1 capital requirement is increased, in terms of both quality and quantity. The proportion of capital of the highest quality within the minimum capital requirement is more than doubled to 8%, and the introduction of additional capital buffers over and above the core capital requirement of 8% means that the total amount of capital to be held under pillar 1 may be higher. For example, Basel III introduces a capital conservation buffer of 2.5% on top of the obligatory minimum capital holding of 8%. In addition, DNB can order a bank to set aside a countercyclical buffer of up to 2.5% if the bank has engaged in excessive lending. This ensures that banks build up a buffer during economically good times, which they can use to cushion losses when the economy weakens. CRD IV also introduces a specific buffer component for systemically important banks and systemic risks. This buffer component will amount to between 1% and 3% for Dutch systemic banks (see Chart 2.4).

Finally, the Basel III Accord introduces an unweighted capital requirement, termed the leverage ratio, in addition to the increased risk-weighted capital requirements. This means that banks – regardless of how risky their assets are – must always hold a certain amount of capital relative to their balance sheet. The leverage ratio thus serves as a backstop for the risk-weighted capital requirement. Starting in 2015, banks will be required to publish the leverage ratio. In Europe, the European Commission will publish a final proposal by 2016, at the latest, for the form the leverage ratio will take. The European Commission aims to make the leverage ratio a binding requirement by 1 January 2018. The Netherlands is arguing at European level for a leverage ratio of 4%, at least for systemically important banks.

European banks can move in stages to comply with the Basel III framework, but must be fully compliant by 2019. Dutch banks draw up migration plans each year describing the steps they intend to take in order to meet this deadline. DNB assesses and monitors these migration plans carefully, including the parallel development of the capital buffers according to both Basel II and Basel III. To this end, DNB has participated since the beginning of 2011 in the Basel III monitoring exercise developed jointly by the Basel Committee and the EBA. The purpose of this exercise is to gain insight into what the capital and liquidity positions of banks will be under the Basel III framework. All Dutch banks (with the exception of branches of EU banks) are taking part. DNB uses these figures in the first instance to increase its understanding of the current and future development of the capital and liquidity position of banks under the new Basel III regime. Additionally, these figures form the starting point for the migration plans.
Supervision: work in progress

Once the capital ratios of the Dutch banking sector have been mapped out, the difference between the Basel II and the full Basel III framework in 2019 will become clear (see Chart 2.5). The available capital buffers expressed in terms of Basel II work out higher than the buffer according to the Basel III standards. This is because Basel III sets stricter standards for the quality of capital. Chart 2.5 also shows that Dutch banks have strengthened their capital ratios substantially in recent years. The Dutch banking sector is on course to fully meet the enhanced solvency requirements of Basel III. DNB will continue to closely monitor the individual institutions’ migration plans.

As a result of the stricter requirements for the quality of capital, many old hybrid instruments (known as Additional Tier 1 or AT1 instruments) no longer qualify as capital under Basel III. These old instruments will be gradually phased out under the CRD IV rules. At the end of 2013, the Dutch State Secretary for Finance sent a letter to the Dutch House of Representatives (Tweede Kamer) announcing

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**Chart 2.4 - Phased-in growth of capital buffer for systemically important banks under Basel III**

As a percentage of risk-weighted assets

<table>
<thead>
<tr>
<th>Year</th>
<th>SIB Buffer (CET1)</th>
<th>Countercyclical Buffer (CET1)</th>
<th>Capital Conservation Buffer (CET1)</th>
<th>Indicative Pillar 2 requirement</th>
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</thead>
<tbody>
<tr>
<td>2012</td>
<td></td>
<td></td>
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<td>2013</td>
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<td>2019</td>
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</table>

Note: The capital buffer in 2012 is shown under Basel II and is therefore not directly comparable with the data for the other years, which are expressed in terms of Basel III. Among other things, the definitions of CET1, Tier 1 and Tier 2 were tightened up under Basel III. In 2019, the major Dutch banks must comply with a risk-weighted CET1 requirement that can be as high as 13.5%, depending on the size of the SIB buffer and the countercyclical buffer. The CET1 requirement is the sum of the minimum requirement (4.5%), the ‘breathing’ buffers (2.5% of capital conservation buffer, 1 - 3% of systemically important/systemic risk buffer, 0 - 2.5% of countercyclical buffer) and a pillar 2 requirement (approximately 1%). The pillar 2 requirement can turn out higher and banks are not obliged to partially use CET1 to meet this requirement.

Source: DNB.
Supervision: work in progress

legislation under which the new Basel III hybrid instruments will be treated as debt capital. This will remove the tax obstacles in future issues of new AT1 debt instruments, enabling banks to strengthen their buffers further. A key reason for this decision is to guarantee a level playing field between Dutch banks and banks in other European countries, almost all of which now permit tax-deductibility of AT1 under their own rules.

2.3.2 Insurers: moving towards Solvency II

An important political agreement was reached at the end of 2013, which brings closer the introduction of Solvency II on 1 January 2016. At the same time, meaningful steps were taken in the Netherlands to make supervision more risk-based and forward-looking, along the lines of Solvency II. These steps were necessary to be able to supervise insurers effectively in the run-up to Solvency II.

In 2013, a milestone was reached on the road to the introduction of Solvency II: the new European supervisory framework for insurers. On 13 November 2013, the European Parliament, the European Council and the European Commission reached a political agreement on the Omnibus II directive. The agreement establishes the main lines of the Solvency II framework and brings its implementation on 1 January 2016 one step closer. Solvency II introduces necessary and fundamental changes in the supervision of insurers, partly by providing building blocks for better risk management, risk-based capital requirements and more forward-looking supervision. In addition, the introduction of Solvency II further harmonises European insurance supervision, thus ensuring that all policyholders will enjoy equal protection in the future.

Note: This chart compares the total capital ratio expressed in terms of Basel II with the core capital ratio (CET1) under Basel III. The reason that the total capital ratio under Basel II is not compared with the total capital ratio under Basel III is that many old hybrid instruments issued by banks (Additional Tier 1/Tier 2 instruments) no longer qualify under the full requirements of the Basel III framework as it will apply in 2019. Therefore, the total capital ratios of Dutch banks, measured according to Basel III as per 2019, differ little from the core capital ratios expressed in Basel III terms. Partly because of the disappearance of tax obstacles, Dutch banks will gradually replace hybrid capital instruments that are being phased out with new qualifying debt instruments.

Source: DNB.

Chart 2.5 - Capital position of Dutch banking sector under Basel II and Basel III

Capital ratios as percentages of risk-weighted assets

<table>
<thead>
<tr>
<th>Total Capital Ratio (Basel II)</th>
<th>CET1 Ratio (Basel III)</th>
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<tbody>
<tr>
<td>18</td>
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<td>16</td>
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<td>8</td>
<td>9.6</td>
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10 H2 11 H1 11 H2 12 H1 12 H2 13 H1 13 Q3

Note: This chart compares the total capital ratio expressed in terms of Basel II with the core capital ratio (CET1) under Basel III. The reason that the total capital ratio under Basel II is not compared with the total capital ratio under Basel III is that many old hybrid instruments issued by banks (Additional Tier 1/Tier 2 instruments) no longer qualify under the full requirements of the Basel III framework as it will apply in 2019. Therefore, the total capital ratios of Dutch banks, measured according to Basel III as per 2019, differ little from the core capital ratios expressed in Basel III terms. Partly because of the disappearance of tax obstacles, Dutch banks will gradually replace hybrid capital instruments that are being phased out with new qualifying debt instruments.

Source: DNB.
A key component of the political agreement on Solvency II concerns the valuation of long-term insurance obligations. The Omnibus II Directive stipulates that the interest rate term structure against which insurance obligations must be valued will contain supplementary add-ons and haircuts. The Directive provides for a transitional period of 16 years for adjustment to the structure. This means that insurers have a maximum of 16 years in which to move from the present interest rate term structure to the structure that will apply under Solvency II. Insurers who wish to make use of this transitional measure must be transparent regarding the effect of its application.

To prepare for the introduction of Solvency II, the European Insurance and Occupational Pensions Authority (EIOPA) issued a number of guidelines in 2013. These preparatory guidelines give national supervisors in Europe tools to help prepare for Solvency II in the areas of good governance, own risk assessment, pre-application of internal models and reporting requirements. By publishing the guidelines, which came into effect on 1 January 2014, EIOPA is aiming to ensure the consistent implementation of Solvency II in Member States. The guidelines are aimed at national supervisors, who are expected to incorporate them into their regulatory frameworks or regimes and apply them to their own national insurance sectors. EIOPA applies the ‘comply or explain’ principle here.

DNB has decided to fully apply the guidelines on good governance, own risk assessment and pre-application of internal models.

Last year, significant steps were taken in the Netherlands as well as at European level to strengthen the supervision of insurers (see Figure 2.2). When it became clear that the introduction of Solvency II on 1 January 2014 would not be achieved, the Ministry of Finance decided – partly in response to lobbying by DNB – not to wait any longer for the introduction of Solvency II but to strengthen Dutch insurance supervision sooner. Dutch life insurers are facing major challenges due to the shrinking market for individual policies (see Chart 2.6), driven partly by growing competition from banks. In addition, the returns guaranteed to policyholders by Dutch life insurers are relatively high by international standards, and this is expensive in the present low interest rate climate. Against this backdrop, the Ministry of Finance decided to make a number of amendments to the Decree on Prudential Rules for Financial Undertakings (Besluit prudentiële regels Wft – Bpr). These amendments include the introduction of own risk assessment and the theoretical solvency criterion (TSC) with effect from 1 January 2014.

The introduction of the TSC marks an important step forward for insurance supervision in the Netherlands. One shortcoming in the present Solvency I framework is that the capital requirement for insurers is not dependent on the investment and insurance risks to which they are exposed; that shortcoming is resolved with the introduction of Solvency II. The TSC will enable DNB, in the run-up to the introduction of the Solvency II framework, to assess the risk profile of medium and large life insurers more effectively from 2014. This is because the TSC serves as a risk-based indicator to establish whether an insurer will fall below the required solvency margin in the coming 12 months, or is in danger of doing so. If this is the case, the insurer must submit a request for a declaration of no objection to DNB to allow it to make dividend distributions or other capital withdrawals. This means that DNB can put a brake on capital withdrawals if the financial position of an insurer is not strong enough. The TSC thus enables DNB to exercise more risk-based and forward-looking supervision.
In the run-up to Solvency II, insurers themselves are critically reviewing the investment risks to which they are exposed. In recent years this led to a shift from investments in equities to fixed-income securities (see Chart 2.7). The average duration of these fixed-income securities has also increased in the life insurance sector, enabling insurers to more effectively hedge the interest rate risk that stems from issuing long-term guarantees to policyholders. Within the fixed-income

Chart 2.6 - Individual life new business
Premium income per year, EUR billion
securities, insurers have increased their investments in mortgages and high-grade
government bonds with a credit rating of AA or higher. These trends can lower
the risk profile of the investments of individual insurers and lead to a reduction
in the future capital requirement under Solvency II.

This year will be dominated by the further development of the Solvency II
framework. Many components still have to be implemented in lower-level
regulations. Examples include establishing the level of the capital requirements
and determining the credit risk haircut in the interest rate term structure.
The European Commission will make a start on this in the first half of 2014.
During this process, it is important that sufficient account is taken of a number
of specific characteristics of the Dutch insurance sector, such as basic health
insurance. In that context, it is essential that capital requirements are realistic for
debt paper with high-quality mortgages as collateral (Residential Mortgage-Backed
Securities or RMBS). At the same time, DNB will continue developing the
Solvency II basic regime at national level. This regime is a customised
supervisory framework for small insurers and funeral expenses and benefits-in-kind
insurers in the Netherlands. In consultation with the Minister of Finance,
DNB will further work out the regulations for the Solvency II basic regime in 2014.

2.3.3 Towards a future-proof pension system
Steps were taken in the past year to make the Dutch pension system more
sustainable. One important step was the design of a new financial assessment
framework (financieel toetsingskader – FTK). Further adaptations are still needed,
however, in order to ensure that the pension system reflects modern Dutch
society, where individuality and flexibility are increasingly important values.
It is essential to retain the strong elements in the system, such as full funding
and mandatory pension savings.

In a good and sustainable pension system, pension funds meet their obligations
and economic stability and growth are supported. In the past year, important
steps were taken to improve the pension system. First, the Reinforcement of
Pension Fund Governance Act (Wet versterking bestuur pensioenfondsen – Wvbp) came into effect. This Act further strengthens the quality and suitability of pension fund governance and the degree to which directors are ‘in control’.

A second step was the reform of the financial assessment framework. In 2013, the blueprint for this new supervisory framework was developed by the Ministry of Social Affairs and Employment in cooperation with DNB. Finally, the affordability of the pension contract was improved by the political agreement in relation to the ‘Witteveen framework’ (see Box 2.1).

The reform of the financial assessment framework is a necessary step that will be worked out further in 2014. An energetic approach is essential here as it will help ensure a solid pension sector and the necessary restoration of confidence in the system. Chart 2.8 shows that the average (nominal) funding ratio at the end of 2013 was in fact back above the minimum required level of around 105%. The real funding ratio stood at 82%, which means there is still insufficient money in the system to compensate for inflation on a structural basis. The real funding ratio is calculated on the assumption of a 2% price inflation rate. It is therefore important to structurally improve the financial basis under the present system, partly bearing in mind the need for a further recovery of consumer confidence. The urgency of this question was expressed convincingly by the Goudswaard and Frijns Commissions in 2010.

Box 2.1: Witteveen framework and generational balance test
In December 2013, the Dutch government reached an agreement with a number of opposition parties on making the tax relief arrangements for pension contributions less generous (the ‘Witteveen framework’). Under the agreement, starting 2015 the maximum pension accrual for an average salary pension scheme will be lowered from 2.15% to 1.875% per annum. In addition, tax relief will be capped at an income of EUR 100,000.

These changes are taking place against the background of a rise in the pensionable age. As people will be working longer, they can still achieve a reasonable pension at a lower maximum accrual rate. At the same time, the government and opposition parties want pension funds that make their pension schemes less generous to ensure that the lower pension accrual is reflected in lower employers’ and employees’ contributions. Lower contributions could support the tentative recovery of the economy. DNB endorses the government’s aims.

At the same time, pension contributions must be in balance with the commitments to pension scheme members. DNB has offered to carry out a generational balance test on pension contributions. This test is intended to ensure that decisions regarding the level of contributions are based on a balanced weighing of interests. The basis for the generational balance test is the Dutch Pension Act (Pensioenwet), which prescribes such a balanced weighing of interests. To support the test, the government will introduce a number of legislative and regulatory amendments. Pension funds will, for example, be forced to be more transparent about pension accrual and to seek advice from the accountability board on the level of contributions. In a letter to the government, DNB announced that it will carry out a sector-wide review in the second half of 2014 to assess the balance between generations in setting the level of contributions for 2015.
Supervision: work in progress

The long-term sustainability of the pension system will require further changes. There is scope for additional improvements in financial sustainability, partly by improving transparency. For instance, it is important for pension scheme members to know the level of their pension and the related degree of uncertainty. Further adjustments are also needed to ensure the societal sustainability of the pension system. In particular, this means making changes to the institutional structure of the system to better align the pension system with today’s society, in which members expect more transparency, demand more freedom of choice and follow ever more varied career paths.

Against this backdrop, the State Secretary for Social Affairs and Employment announced the intention to launch a broad public debate in 2014 on the future of the Dutch pension system. A logical theme in this debate is uniformity. In the present system, pension funds are required to treat all members largely identically as regards contributions, entitlements and investment policy. One example is the ‘flat-rate contribution’, whereby members – regardless of factors such as their age – pay the same contribution for the same pension accrual. However, employment patterns today are more diverse, partly because of the rise in self-employment, career interruption for study or care leave and regular changes of employer. It is therefore important for the clarity of the system that the scope for a transition from the flat-rate contribution to a different system is explored further.

From a macroeconomic perspective, it is also important to strike a better balance between stable contributions and stable pension benefits. Where pension contracts focus purely on the level of benefits, financial setbacks often create pressure to raise pension contributions. While such a step would strengthen the financial position of the pension fund, it could also have a procyclical effect. After all, changes to contributions – via the employers’ contributions – have an impact on the competitiveness of companies and on employment. A possible alternative would be a stable pension contribution. However, where a pension fund pursues a risky investment policy, a stable contribution can lead to volatility in pension entitlements and benefits. This also affects the macro-economy through consumer confidence, though the cyclical effect of volatility...
in contributions is generally greater than the effect of volatility in entitlements and benefits as changes in pensions that have not yet come into payment have a less direct economic impact. At the same time, the primary aim in the present system is that pension contributions should be self-financing, which can be at odds with stabilising contributions. One possible way of ensuring that contributions remain self-financing is to introduce flexible pension accrual. This alternative has a smaller macroeconomic impact than large fluctuations in contributions.

Finally, it is important in the broad public debate to preserve the strong elements of the Dutch pension system. For example, the Dutch system sets itself apart internationally owing to its funded status and mandatory pension saving. The collective nature of Dutch pensions is also a strong feature. Collectivity leads to benefits of scale and enables risk sharing, so that good times and bad times can be spread across different generations. There are, however, limits to this form of solidarity; imposing a disproportionate burden on certain groups of members can put pressure on the collective nature of the system. If support is to be maintained, the forms of solidarity should be transparent.

2.4 The changing face of supervision

DNB has intensified its prudential supervision in recent years. However, prudential supervision is never ‘finished’. The recently published DNB Supervisory Strategy 2014-2018 describes a number of areas of supervision to which DNB will devote extra attention in the coming years. Key focus areas include integrity supervision and transparency regarding supervisory activities and their impact. By rendering clear account to society, supervision can bolster confidence in the Dutch financial sector and in supervision. With this in mind, the supervisory ambitions and related KPIs formulated in 2012 will be further embedded in DNB’s supervisory activities in the year ahead.

It is not just the legislation and regulations that have been tightened up in response to the financial crisis; DNB’s prudential supervision has also been further intensified in recent years. This was first set out in DNB’s Supervisory Strategy 2010-2014 and in the Action Plan for a change in the conduct of supervision drawn up in 2010. Supervision has become more forward-looking by emphasising strategic and qualitative elements such as an institution’s business model and its culture and decision-making processes. These factors can have a major impact on the long-term solidity of an institution. Supervision also looks more explicitly at risks across individual institutions. DNB safeguards the links between macroprudential analysis and microprudential supervision in several ways. The Financial Stability division plays a central role here through macroeconomic monitoring, drawing up a macro-register for supervision and setting policy for the orderly recovery and resolution of institutions.

Supervision was also made more thematic with the introduction of the new FOCUS! supervisory approach in 2012. As a result, DNB more often analyses and addresses prudential risks at sector level instead of focusing on individual institutions. DNB now deploys approximately 25% of its supervisory capacity on supervisory themes. A recent survey showed that supervised institutions actually experience the supervision as being more intensive, more intrusive and more conclusive (see the 2013 ZBO report). There is a greater willingness to take action.

Meanwhile, the supervisory organisation has been strengthened. First, DNB reorganised in 2011; the role of the expertise centres was reinforced,
internal quality control intensified and intervention & enforcement were given a separate and stronger position within the organisation. In February 2012, the Act strengthening governance of financial supervisors DNB and AFM (Wet versterking herziening governance DNB en de AFM) came into force. This Act underpins the autonomous role of prudential supervision. Second, DNB succeeded in raising the level of specialist expertise through internal training courses (formerly conducted by the Supervisory Academy; since 1 January 2014 the DNB Academy) and external recruitment. Third, in 2013 DNB started using performance measurement as an instrument to manage its own supervisory organisation and render account to external stakeholders. Measuring results is a standard component of supervisory examinations. As far as possible, results are made public in the annual ZBO report and updates.

However, prudential supervision is never ‘finished’ and DNB will continue its efforts in the above areas. Due to the exceptional financial sector dynamics, supervision is required to keep adapting to relevant new developments in the sector. This is reflected in the new Supervisory Strategy 2014-2018. This document formulates ambitions for the financial sector and sets out four new core focus areas for DNB supervision, building on the direction DNB has taken in the DNB Supervisory Strategy 2010-2014. First, it is very important that the ECB becomes an effective supervisor, and that DNB is able to function effectively within the SSM. DNB gives high priority to achieving this. Second, DNB continues to strengthen its own supervisory approach. To this end, DNB is looking to strengthen its information base, among other things by focusing on good data quality, further strengthening the link between the macro and micro levels, carrying out more in-depth supervisory examinations at institutions and remaining constantly alert to underlying patterns. Third, integrity supervision will be strengthened. The initiatives planned include formulating an integrity supervision strategy across the supervisory spectrum, creating clarity about priorities and internal roles and ensuring that signals from the field are shared more effectively. Finally, where possible, DNB will seek to be transparent by providing more information about financial institutions and the effectiveness of its supervision, as part of the dialogue with external stakeholders. Impact measurement is an important instrument in this respect.

The following sections look in more detail at integrity supervision, the related supervision of conduct and culture at institutions, and supervision impact measurement.

2.4.1 Integrity supervision

In addition to financial stability, integrity is a key condition for confidence in the financial sector. Recent events, such as the SNS Property Finance affair and the Libor scandal, have shown that infringements of integrity can have far-reaching consequences. Integrity-related incidents damage trust and confidence in an institution, and have financial consequences through fines, damage claims and loss of clients. In this sense, there is a clear interaction between prudential and integrity risks. In addition to carrying out prudential supervision, DNB also supervises the integrity of financial institutions; this task is laid down in the Financial Supervision Act (Wet op het financieel toezicht – Wft), the Anti-Money Laundering and Anti-Terrorist Financing Act (Wet ter voorkoming van witwassen en de financiering van terrorisme – Wwft) and the Sanctions Act 1977 (Sanctiewet – Sw).
The purpose of integrity supervision is to ensure a sound financial sector. It is vital to prevent the trust and confidence in a financial institution or the financial sector as a whole from being undermined. Consequently, integrity supervision is primarily preventative in nature and aims to avoid infringement of integrity by setting standards for the structuring of an institution’s business operations. Following an incident or other indications of a lack of integrity, the focus of the supervision becomes investigative. Where necessary, DNB will cooperate in the Financial Expertise Centre (FEC) with other authorities that are active in the fields of supervision, audit, investigation and prosecution. Apart from sanctions that may be imposed for infringement of integrity, an institution will be required to structure its business operations in such a way that these types of infringements are avoided in the future.

DNB’s integrity supervision targets three types of integrity infringement, namely those whereby the institution perpetrates, facilitates or is a victim of an integrity infringement. Preventing money laundering and the financing of terrorism are often mentioned in the same breath as cybercrime, yet there is an important distinction between them: an institution facilitates money-laundering, whereas in the case of cybercrime the institution is the victim of an integrity incident. The infringement of integrity can also come from within the organisation itself. An example would be the taking of bribes or misconduct by staff when setting interest rates, as in the Libor scandal. When determining the necessary supervisory action, it is important to make a distinction between the different types of integrity infringement. Each type has a different impact on an institution and demands a different approach from both institution and supervisor.

DNB will intensify its integrity supervision in the coming years and is developing a broad-based strategy for integrity supervision, the central plank of which is detecting integrity infringements. Risk analysis and information sharing within DNB are also being improved so that patterns can be detected more readily using the existing information. To this end, DNB will draw on the experiences of the Netherlands Authority for the Financial Markets (AFM.), among other things. Finally, the introduction of the SSM will also have consequences for DNB’s integrity supervision. Although this will continue to be a national task, the ECB – as the prudential supervisor – will wish to ensure sound and ethical business operations. Prudential and integrity supervision are related on this point, and close cooperation and clear agreements with the ECB are therefore necessary in order to avoid overlaps and blind spots in supervision.

2.4.2 Supervision of conduct and culture of financial institutions

Supervision of the conduct and culture of financial institutions – and, in relation to that, their internal governance – has steadily gained in importance since the onset of the financial crisis. The shortcomings that emerged during the crisis have led to new legislation and regulations in the financial sector aimed at repairing these internal governance defects. Figure 2.3 presents an overview of the new rules and principles, and shows that developments have followed each other in rapid succession, not only with regard to governance provisions in legislation, but also in terms of codes and principles. The focus in many of the governance measures put in place since 2008 is on conduct and the influence of aspects of conduct on the governance of institutions and the effectiveness of risk management.

Among the measures expected in 2014 are new rules on remuneration policy and suitability tests. These rules are partly the result of national developments,
Supervision: work in progress

such as the Coalition Agreement and changes to the Dutch pension system, but are in fact largely due to developments at European level. Based on recommendations by the Financial Stability Board (FSB), changes have for example been made in the area of remuneration, whereby bonus payments have been capped or prohibited within a short space of time. Following all the efforts to bring about behavioural change, time alone will tell whether the new governance standards prove to be effective in practice. Society expects supervisors to make clear how effective their supervision is. With this in mind, DNB has initiated a project that measures the impact of its supervision on the suitability of directors and remuneration policy. These measurements should reveal in 2014 whether the policy pursued has had the envisaged effect.

2.4.3 Supervision performance measurement

The importance of performance measurement in financial supervision has increased greatly since the outbreak of the financial crisis. By rendering clear account to society, supervision can help restore confidence in the Dutch financial sector. DNB actively seeks ways to make the impact of its supervision more transparent, which means that it places more emphasis on impact measurement. Against this backdrop, DNB formulated four ambitions in 2012 for its supervision of the financial sector. First, supervision must minimise the risk of bankruptcies and instability. Second, DNB’s supervision must be classed as a best practice at the international level. Third, supervision has the explicit task of promoting confidence in the Dutch financial sector. Finally, the authority of DNB’s supervision must be taken as read by the Dutch financial sector. These four central ambitions have been operationalised in the form of key performance indicators (KPIs), which show to what extent DNB is meeting its supervisory ambitions. The first measurement of the KPIs was carried out in 2012, after which the measurement and reporting process was fine-tuned in 2013 (for the results, see the 2013 ZBO report). In 2014, DNB will perform quarterly measurements to determine the progress in realising its four ambitions.
Ambition 1: Supervision minimises the risk of bankruptcies and instability

With this ambition, DNB seeks to ensure that no assets are lost through bankruptcies. To minimise the risk of bankruptcies, DNB applies stepped supervisory regimes, in which the supervision becomes steadily more intensive (from low-threshold to urgent). If DNB raises the supervisory regime for an institution, the intervention strategy also changes. Financial institutions in the highest regimes must formulate and implement an improvement plan in close consultation with DNB, so that they move out of the enhanced supervision regime as quickly as possible. Institutions with a high risk profile should spend no more than one year in the enhanced supervision regime. Based on past experience, this is a strict target. Nonetheless, DNB believes it is important to apply this standard.

Ambition 2: DNB’s supervision is classed as best practice internationally

In a small, open economy with a relatively large financial sector, supervision should be of the highest quality. This ambition is intended to ensure that DNB’s supervision is among the best in the world. A good indicator of this is the score in the International Monetary Fund’s (IMF) regular Financial Sector Assessment Program (FSAP). In a FSAP, the IMF assesses aspects such as the quality of financial supervision in the 188 member countries, including the Netherlands. The next FSAP for the Netherlands will take place in 2015. DNB’s supervision is also regularly assessed by other international bodies, such as the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS) and other international standard-setters in the sector. Its performance is then compared with that of its fellow-supervisors. These organisations establish rules and best practices that national supervisors must meet or that can be used as a benchmark. From November 2014, the ECB will also be a critical observer, based on its responsibility for the supervision of significant banks in the euro area. With regard to international benchmarks, DNB is seeking to improve its previous score and be among the top five countries in the benchmark.

Ambitions 3 and 4: Supervision promotes confidence and has authority in the Dutch financial sector

Since 2013, DNB has carried out an annual survey among external stakeholders, among other things to assess confidence in the Dutch financial sector and DNB’s authority (see the 2013 ZBO report). DNB’s reputation is also measured using the ‘reputation monitor’ developed by Erasmus University Rotterdam. This measurement takes the form of a quarterly survey held among Dutch citizens with an above-average interest in and knowledge of the financial world (‘financial citizens’). The results can then be compared with those of other organisations. In addition, DNB fulfils the role of gatekeeper for market access for financial institutions and directors. If licences granted and director approvals must be rescinded at a later date, this has a negative impact on confidence in DNB. To assess the level of due care employed in these procedures, DNB therefore applies the norm that no problems must arise within two years of the approval of a director or the issuance of a declaration of no objection.

It is important that KPIs and targets are always viewed in context. There may be a good reason for failure to achieve a target which – provided it is properly substantiated – need not detract from the ability to achieve an ambition. Given the interconnectedness and interdependencies within the financial sector, it is difficult to entirely exclude external influences from a performance measurement. Conversely, hitting a target does not by definition mean that the ambition in question has been achieved. Naturally, it is not just the current score on the KPIs (‘the snapshot’) that is important, but also the development
Supervision: work in progress

(‘the film’) of those indicators over time. Only then do improvements become clearly visible. With a view to the accountability and continuous improvement of supervision, DNB will further embed its ambitions and KPIs in its supervisory practice in the year ahead.
Payment and settlement system: challenges and opportunities
3 Payment and settlement system: challenges and opportunities

3.1 Introduction
The key aim of the payment and settlement system is invariably to ensure that security, reliability and efficiency are preserved amid technological, economic and social changes.

This chapter examines the following topics: measures in response to disruptions and DDoS attacks in the spring of 2013 (Section 3.2); innovations and their impact on security and efficiency, including the far-reaching transition to SEPA standards (Section 3.3); developments in the cash distribution and processing market (Section 3.4); and dealing with a potential scarcity of good-quality collateral (Section 3.5).

3.2 A secure and reliable payment system
The analysis carried out by the National Forum on the Payment System (Maatschappelijk Overleg Betalingsverkeer – MOB) in 2013 showed that the Netherlands has a well-functioning payment system. However, it identified three areas where user groups would like to see greater availability or improvement of alternative payment methods.

3.2.1 Analysis of the robustness of the payment chain
Technological developments imply increasing freedom of choice with regard to payment methods, but also create a more complex payment chain and risks of breakdowns. The breakdowns and DDoS (Distributed Denial of Service) attacks in April 2013 prompted MOB to analyse the robustness of the payment chain. The Forum looked at what alternative payment products were available for credit transfers, direct debits, inpayment transfers (acceptgiro), iDEAL, credit cards, debit card payments, electronic purse cards (chipknip), cash and ATM withdrawals, and how quickly and on what scale these alternatives could be brought into use if a payment product was no longer accessible through a specific channel or multiple channels. The analysis concluded that the Dutch payment system is robust. There are alternatives to existing payment products or there are several different methods (channels) that can be used to effect the payment. User groups identified three areas where they would appreciate action to increase availability and provide improved alternatives: online banking, iDEAL (the payment standard for secure direct online payments via e-banking) and debit card payments. Banks have already taken steps to improve the resilience to DDoS attacks, and work is also ongoing to upgrade the fallback
capability of mobile banking for consumers. Moreover, banks are taking technical measures to reduce the interdependencies between online banking, mobile banking and iDEAL, and are working on a mobile variant of iDEAL. For debit card payments, banks and retailers are exploring fallback options. The measures taken will be evaluated by MOB in the first half of 2014.

In addition, two legislative changes have strengthened the supervision of the payment system. Firstly, with effect from 1 February 2014, clearing and settlement institutions (parties that forward, approve or net payment instructions) are subject to supervision. And secondly, on 1 January 2015 the Financial Supervision Act (Wet op het financieel toezicht – Wft) will explicitly state that rules can be set for the operations of authorisation holders to promote the effectiveness of the payment system.

3.2.2 Cyber attacks in the payment and settlement system
Cyber attacks target both the availability and the integrity of various products, channels and organisations in the payment and settlement system. The DDoS attacks in April 2013 led to the temporary shutdown of online banking systems and services. Cyber criminals seek financial gain and develop attacks using malware and phishing techniques. Banks have invested heavily to increase their ability to monitor, detect and block fraudulent transactions in their payment systems. The fraud figures stabilised in 2012 and began to decline from 2013 onwards (see Chart 3.1). In the Netherlands, too, debit card skimming has been a major problem for years. The level of security has ultimately been increased and the losses from skimming have been contained considerably. This was achieved through the introduction of the EMV chip to replace the magnetic strip and a measure referred to as ‘geo-blocking’ – the standard blocking of debit cards for payments outside Europe – unless customers specifically indicate they want to have this block lifted temporarily or permanently.

Given the increase in the number and complexity of attempted attacks, it is vital that banks continue to refine their countermeasures. This applies to mobile banking as well, which has grown so fast within the space of two years that it is now used more widely in the Netherlands than traditional PC-based online banking. De Nederlandsche Bank (DNB) ensures that institutions address these developments adequately and take measures to combat risks that could undermine controlled business operations. The thematic examination of information security, which has been ongoing for several years now, shows that

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**Chart 3.1 - Fraud-related losses at banks**

EUR million

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Source: NVB (Netherlands Bankers’ Association).
the level of information security has improved since 2010. A thematic examination of complex ICT infrastructures will be initiated in 2014.

At European level, prudential supervisors and payment supervisors (overseers) have joined forces in the Security of Retail Payments Forum, which was established by the ECB in 2011. In early 2013, to apply more uniform rules for online retail payments, the ECB published a series of minimum security recommendations for online banking and online card payments. Supervisors and overseers can incorporate these recommendations into the assessment frameworks at national level. The Netherlands already amply met these standards.

At global level, the Basel Committee on Payment and Settlement Systems (CPSS) is developing policy in relation to cyber security for financial market infrastructures (FMIs) such as systemically important payment systems, central securities depositories and securities settlement systems, central counterparties and trade repositories. The efforts are focused on FMI initiatives aimed at increasing the resilience to cyber threats, and target both the participants and the operator responsible for the processing, settlement and logging of transactions in the payment and settlement systems. Specific attention is being devoted to situations where a cyber attack infects both the primary system of an FMI and its backup facility. Given their critical role in the financial system, FMIs fall under the oversight (payment supervision) of central banks. The accountability for the performance of DNB’s oversight of payment and settlement systems is set out in the 2013 Oversight of payment and settlement systems report.

In October 2013, the Dutch government published the National Cyber Security Strategy 2, setting out a line of action for combating cybercrime in the financial sector by strengthening cooperation. This helps to structurally strengthen the enforcement capacity. The government’s aim is that private sector operators should actually play a role in public sector structures, partly through the liaison structure of the National Cyber Security Centre (NCSC), to which people from a number of vital sectors have been seconded. Since October 2013, Dutch banks have had a permanent representation in the NCSC, further reinforcing cooperation in the event of cyber incidents in the private and public sectors.

The payment and settlement systems will be further affected by technological and market developments in the years ahead. Meanwhile, cyber threats will continue to develop and target the availability and integrity of different products, channels and organisations. It is therefore essential that both private and public sector operators take measures that safeguard the security of the entire chain, and it is important that they continue to work on measures in 2014 to further strengthen both the individual and collective resilience to cyber threats.

3.3 Faster and more efficient payments

Innovations in the payment system often improve efficiency and are therefore desirable, provided security and safety are adequately guaranteed. Ease of use and adequate security determine whether consumers, businesses and retailers will use a given payment option.

3.3.1 SEPA, a basis for innovations at European level

The biggest change affecting the payment system in recent years is the transition to European standards for credit transfers and direct debits. This has laid the basis for the Single Euro Payments Area (SEPA), which enables consumers and
businesses to easily transfer and receive payments in euros to and from accounts in other countries. The most noticeable change for consumers is the conversion of their old bank account number into the longer IBAN account number. SEPA is one of the biggest projects ever undertaken in the Dutch payment system and creates substantial project and operational risks. In response to this, DNB set up a special agency in 2011 to organise the transfer of the Netherlands to the new standards. Their IBAN promotion campaign encouraged banks, large corporations, SMEs, software companies and consumers to make preparations for the migration to SEPA. At European level, it was decided at the start of 2014 to extend the original deadline of 1 February 2014 by a further six months. The Netherlands was largely ready for the migration on 1 February.

Now that the SEPA migration in the Netherlands and Europe is virtually complete, it is time to look ahead. The standardisation of the main payment products opens the way for more competition, and therefore more efficiency, lower costs and better (more innovative) products. It will for example be easier to process payments at European level, creating scope for consolidation and therefore cost reductions through scale effects. For instance, the Netherlands-based payment processor Equens also processes part of the German and Italian retail payments. And SEPA creates opportunities for new payment services that can be used across the whole euro area. A case in point is the e-mandate that is being developed for the SEPA direct debit; this digital authorisation for a direct debit collection represents a considerable efficiency improvement compared with the present paper forms. But SEPA will also act as an incentive to find solutions to enable more and more payments to be made automatically, with a single click. This will obviate the need to manually type in long payment references on payment transfer forms, for example.

While SEPA offers multiple opportunities for improving the European payment system, this will not happen automatically. Ensuring that the payment system continues to meet users’ needs and requirements will demand increasing cooperation at European level. It was therefore a welcome move when, in December 2013, the ECB created the Euro Retail Payments Board (ERPB), which brings together providers and users of payment services. The ERPB is the European counterpart of the Dutch National Forum on the Payment System (MOB). National central banks play an important role within the ERPB as a link between the national and European level. There are still differences between countries in terms of infrastructure and payment habits, and discussions will therefore initially mainly take place at national level. The Netherlands, for example, is exploring possibilities to speed up the processing of payments, for example by enabling payments to be credited at weekends as well as during the week. Ultimately, however, European solutions are preferable to national ones to benefit most from the single market.

3.3.2 Recent payment innovations

One important payment innovation that will change checkout behaviour is contactless payment. In 2013, this new payment method was tested in the Netherlands by three banks – ABN AMRO, ING and Rabobank – as part of the temporary Mobile Payment project in Leiden. In addition, several parties in the payment system began issuing new debit cards with contactless chips. The user’s mobile phone or debit card is held a short distance from the point-of-sale (POS) terminal in order to carry out the payment. A PIN need not be keyed in for low-value payments, which speeds up the payment process. The limit has been set at EUR 25 in order to restrict financial loss in the event of card misuse,
for example through loss or theft. The contactless technology has the same level of security as a debit card with a chip that is used in POS terminals. As contactless payment is primarily intended for relatively small amounts, it will replace the chipknip electronic purse card, which will be abolished with effect from 1 January 2015. Currently, consumers mainly use cash for small payments; in 2012, 79% of payments up to EUR 5 were made in cash. Depending on the number of POS terminals suitable for this technology and on the reaction of the public to the new payment method, the introduction of contactless payment could lead to a further decline in the number of cash payments.

A new mobile POS terminal (M-POS) was launched for retailers who are not yet able to offer customers the option of debit card payments. Retailers can connect this device to their smartphone or tablet, enabling them to accept card payments. This device works in the same way as a POS terminal. Major card companies carry out security checks on the M-POS terminals and issue a certificate for approved devices. The costs of the M-POS terminal are lower compared to a regular POS terminal and providers generally do not charge a monthly fee, but rather a percentage per payment. This considerably lowers the entry threshold for retailers who need a POS terminal only occasionally.

For some years, payment service providers have been offering consumers and web retailers online payment facilities based on online banking. The payment service provider gives access to the payment account on behalf of the consumer in order to make the payment to the web retailer. Already in 2009, DNB indicated that it had serious concerns about the technical configuration of this solution. Security is at stake because a party other than the account holder is given access to the payment account. At the end of 2012, DNB developed the dual consent approach for providing secure and reliable third-party access to payment accounts. That access is only granted after both the customer and the bank have given their agreement. This approach also includes the recommendation that the third party be placed under supervision within the recast Payment Services Directive. This view is supported by Dutch stakeholders, including the online retail organisation Thuiswinkel.org, the Netherlands Bankers’ Association, the payment system facilitator Currence and the Dutch Consumer Association, and is set out in a joint position paper. The European Parliament and the EU Council will debate the revised version of the Payment Services Directive in 2014. Under the proposal by the European Commission, the third party in the transaction will be placed under supervision. However, the dual consent approach has not been incorporated in the proposal.

3.3.3 Bitcoin, a development outside the usual parameters
A development that falls outside the usual systems and therefore raises national and international questions is the virtual bitcoin currency. Bitcoin is a decentralised system based on a cryptographic calculation whereby linked-up network computers together generate the digital bitcoin currency. Users can buy bitcoins from online exchange offices and place them in a virtual bitcoin wallet. The network not only generates bitcoins, but also serves as the payment system. Each bitcoin and each wallet has a unique number, which is not linked to an identity or name. However, its anonymity also makes the bitcoin attractive to criminals. For example, bitcoins can be used to launder money and transactions can be effected without being overseen by the authorities. Making bitcoin payments is virtually free and very fast. Moreover, there are no national borders within the network, meaning that it makes no difference where the payer and recipient are located. This is different from the regular payment system,
where payments to the other side of the world involve fairly high transaction charges. Legal tender derives its reliability from the fact that the money is issued by a central bank, and from the confidence that is placed in banks, for example through the deposit guarantee scheme. This is not the case for bitcoins: there is no organisation that can offer that level of confidence. If an online service for bitcoin wallets fails or is hacked, customers will lose their bitcoins. In December 2013, DNB therefore issued a warning that consumers should be aware of these risks. Virtual currencies fall outside the scope of the Financial Supervision Act, which means there is no supervision of the currency or the entities that offer bitcoin services.

3.4 Cash distribution and processing in a state of flux

The use of cash is declining. As DNB considers it very much in the public interest that cash remains widely accessible and usable, efforts are made to organise the distribution and processing of cash in the Netherlands more efficiently.

A total of 3.8 billion cash payments were made in the Netherlands in 2012, down more than 13% compared with two years earlier (see Chart 3.2). Cash withdrawals from ATMs and bank counters fell to an estimated EUR 47 billion in 2013, a decline of over 10% in two years (see Chart 3.3). The declining use of cash means that the relative impact of the fixed costs of distributing and processing banknotes will increase. For example, the extensive network of ATMs is a major cost item for banks, while cash transport and processing also carry fixed costs. In order to reduce the fixed costs, banks are rationalising their ATM networks. The number of bank ATMs in the Netherlands had fallen to under 7,700 at the end of September 2013, 800 fewer than four years earlier (see Chart 3.4). Banks are also raising their fees for handling cash, in particular the fees retailers have to pay for depositing and withdrawing cash. These fee increases may prompt retailers to further promote debit card payments, something that DNB regards as a positive development.

However, as cash still plays a key role in the payment system, it is very important that it remains easy for consumers to withdraw cash from their bank accounts, that retailers still have good facilities for depositing their earnings into their accounts and that cash can still generally be used for making payments. To date, cash is the only payment instrument that is accepted virtually universally for point-of-sale transactions. No less important, it is the last remaining alternative if the electronic payment chain fails to function for any reason, for example during a technical breakdown or cyber attack. Moreover, there are still people who, perhaps temporarily, do not have access to a debit or credit card.

DNB therefore encourages efforts to make the distribution and processing of cash more efficient. This will allow better control of costs without affecting the accessibility and usability of cash. The three-yearly study by MOB provides important information on this issue. The 2013 study showed that accessibility is still good in the Netherlands: 99.8% of residents have access to a bank ATM within a radius of five kilometres. The accessibility of cash is also enhanced by the growing number of non-bank ATMs. These are now installed at approximately 800 retail locations across the Netherlands, mainly in supermarkets.
Chart 3.2 - Cash and debit card transactions (billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash transactions</th>
<th>Debit card transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>2011</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>2012</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

Chart 3.3 - Cash withdrawals

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash withdrawals (EUR billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>70</td>
</tr>
<tr>
<td>2010</td>
<td>60</td>
</tr>
<tr>
<td>2011</td>
<td>50</td>
</tr>
<tr>
<td>2012</td>
<td>40</td>
</tr>
<tr>
<td>2013</td>
<td>30</td>
</tr>
</tbody>
</table>

Note: for ATMs and bank counters; 2013 estimate.

Chart 3.4 - Number of ATMs

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of ATMs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>9,000</td>
</tr>
<tr>
<td>2010</td>
<td>8,500</td>
</tr>
<tr>
<td>2011</td>
<td>8,000</td>
</tr>
<tr>
<td>2012</td>
<td>7,500</td>
</tr>
<tr>
<td>2013</td>
<td>7,000</td>
</tr>
</tbody>
</table>

Note: September 2013.
The restructuring of the cash-in-transit and cash processing market is a very important factor here and was set in motion by the creation of Geldservice Nederland (GSN). In 2010, the three largest Dutch banks decided, in consultation with DNB, to set up this jointly owned subsidiary to carry out a large proportion of their banknote handling activities. GSN now processes the banknotes that these banks receive from their customers. Ultimately, GSN will also take over responsibility for arranging the maintenance and filling of bank ATMs, as well as the related cash-in-transit activities. GSN will contract companies to carry out these activities on its instructions. This will lead to considerable efficiency gains, which are necessary in order to ensure that cash remains affordable.

The transition, which will take place in 2015, is having considerable consequences for cash-in-transit companies which have traditionally handled these activities for the banks.

The changes taking place in the cash distribution and processing market also place demands on DNB’s supervision. The concentration of the banknote handling activities of the major banks at GSN has caused cash-in-transit companies to focus more on providing services to retailers. Those services enable retailers to pay their cash takings into their bank account without having to use the cash deposit facilities offered by their own bank. As a result, a non-bank intermediary may temporarily become the owner of this cash. In view of the associated risks, such intermediaries must be placed under prudential supervision of DNB as payment service providers. Another aspect is cash supervision, which has been a DNB task for some years. The main object of this supervision is to ensure that ATMs are stocked with genuine banknotes. Although losses due to counterfeit cash in the Netherlands are relatively limited (see Table 3.1), combating this phenomenon remains important, as evidenced by the increased number of counterfeit notes intercepted in 2013.

### Table 3.1 Counterfeit euro notes intercepted in the Netherlands

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counterfeit notes</td>
<td>54,949</td>
<td>39,631</td>
<td>29,710</td>
<td>29,291</td>
<td>37,700</td>
</tr>
<tr>
<td>of which EUR 50 notes</td>
<td>79%</td>
<td>70%</td>
<td>63%</td>
<td>60%</td>
<td>69%</td>
</tr>
<tr>
<td>of which EUR 20 notes</td>
<td>14%</td>
<td>21%</td>
<td>27%</td>
<td>30%</td>
<td>23%</td>
</tr>
<tr>
<td>Financial loss (EUR million)</td>
<td>2.8</td>
<td>1.9</td>
<td>1.5</td>
<td>1.4</td>
<td>1.9</td>
</tr>
</tbody>
</table>

#### 3.5 What if good-quality collateral becomes scarcer?

Several financial institutions are anticipating a shortage of specific collateral assets in the coming years. While there are no fears of a complete shortage, this expectation of collateral shortfalls is apparent from discussions with Dutch-based financial institutions, which are taking steps to minimise the risk. These market reactions offer advantages, but could also create financial stability risks, such as increasing interdependence, procyclicality and asset encumbrance.

Use of collateral is one of the most important techniques in mitigating counterparty risk; it is used primarily in the money market, derivatives markets, payment and settlement systems and credit operations with central banks. Demand for high-quality collateral is increasing; since the financial crisis, market participants have been less willing to provide unsecured finance and new regulations have
been introduced such as the liquidity standards set by Basel III, the new European regulation of OTC derivatives (EMIR) and internationally agreed collateral requirements for bilateral OTC derivatives. Although the demand for high-quality collateral in the euro area is rising faster than the supply, an absolute shortage is unlikely. Still, individual financial institutions may face a shortage of specific collateral assets. The new OTC derivatives regulation means that pension funds and insurers will have to meet their collateral obligations more often in the form of cash or high-grade liquid government paper, potentially leading to a shortfall of such assets. Banks could also experience shortages, for example if the present liquidity portfolio does not meet the Basel III standards.

Financial institutions can reduce their need for collateral by engaging in fewer high-risk transactions. If these transactions do not directly serve a business objective or help reduce excessive leverage and speculation, this will benefit financial stability. However, one possible undesirable effect is that institutions avoid collateral-based transactions that are designed to cover balance sheet risks.

Financial institutions are also taking steps to professionalise collateral management, by improving their information systems and optimising the use of assets already in their possession. That process of collateral optimisation is complex and increases the internal interdependencies within financial institutions – all the more so if they are institutions that hold collateral in several countries or use external service providers. Recovery and resolution plans must be in place to address these internal interdependencies.

Another possible market reaction is to create new (collateral) assets by securitising loan portfolios, e.g. mortgage books. This leaves balance sheet assets, such as high-grade government paper, available for other purposes. One risk of increased securitisation is that the assets on a bank’s balance sheet become increasingly encumbered. In the event of the bank’s failure, few funds will be left over for unsecured depositors and the deposit guarantee scheme.

A number of financial institutions are also considering collateral transformation: borrowing high-quality assets using lower-quality assets as collateral. An institution that is itself active in the repo or securities lending market (Party A in Figure 3.1) can borrow cash from a bank or high-grade government bonds from institutional investors. Some service providers (including clearing members) also offer collateral transformation services. Sometimes they deliver the requested assets from their own books; sometimes they obtain them from the market (see Figure 3.2). Collateral transformation can enable financial institutions with a shortage of specific collateral assets to borrow those assets from parties that are not currently using them. A key risk is that the financial system may become more interdependent, more complex and less transparent. In addition, collateral requirements are often procyclical (stricter in times of market uncertainty), so that parties dependent on collateral transformation are forced to provide more assets in uncertain times or – in the worst case – find that the transformation
service provider is unwilling to extend the contract. This can lead to major problems, for example because the party concerned is then forced to sell its assets at rock-bottom prices. Collateral transformation is therefore something that warrants close attention.
From a Dutch to a European institution: celebrating 200 years of DNB
De Nederlandsche Bank (DNB) celebrates its 200th anniversary this year. Founded by King William I in 1814, the bank by virtue of its actions steadily won the nation’s trust and evolved into a genuine national bank for the entire Dutch people. In 1914, DNB warded off a bank run and thus definitively established itself as ‘the bank of banks’ in the Netherlands. After the Second World War, DNB contributed to the country’s financial stability by acting as a true guardian of the guilder – a role it continued to fulfil until the arrival of the electronic euro in 1999, followed three years later by the introduction of euro notes and coins. And now a new landmark is imminent: the transition at the end of this year from national to European banking supervision.

DNB’s first centenary celebration was given added lustre with an April fool’s hoax. In a full-page report, newspaper Het Leven claimed that three French gangsters had robbed several bars of gold from DNB’s head office in Amsterdam, having gained entry to the building by melting away the bars of a cellar window with an ‘acetylene-oxygen flame’. The police gave chase, it said, but the gangsters escaped.

Four months later, the readers of Het Leven received a real shock. Once again DNB found itself under threat. This time, however, the culprits were not fake gangsters, but all-too-real panicking customers who had spent the night waiting outside DNB’s head office on the Oude Turfmarkt in Amsterdam. Police had to be called in to restore order and fainting ladies needed to be revived with eau de cologne. The run on DNB had been triggered at the end of July 1914 when the stock exchange bell on the nearby Damrak was sounded, calling all conscripts to report to their army units. The national mobilisation was motivated by fears that the Germans would advance towards France through the Dutch province of Limburg. Despite hasty reassurances from the German government that it would respect Dutch neutrality, calm was not immediately restored. For days, long queues of worried citizens waited outside the DNB building.

As banknotes were not always accepted for payments, people turned to the DNB agencies to exchange their notes for coins. The stocks of coins held by DNB and its agencies rapidly dwindled and the whole payment system was in danger of grinding to a halt. DNB President Gerard Vissering saved the day: he proposed that the government would temporarily issue vouchers for the silver. A week after the mobilisation, the first ‘silver coupons’ could already be exchanged for banknotes. At the same time, businesses were crying out for banknotes. Unable to meet the demand, DNB decided to issue emergency notes. These were simple pieces of paper, with a simple decorative edge but no watermark. DNB’s Governing Board also decided to circulate a limited number of banknotes that were specifically intended for payments between financial
institutions. DNB’s rapid intervention was a Herculean task: the transportation of the banknotes was such a huge operation that the trains could not cope and, for the first time in history, cars were used to get the banknotes to their destination. At the same time, DNB was asked to take part in a support fund for stock exchange members who were at risk of running into payment difficulties. Representatives of the Amsterdam ‘haute finance’ community came, cap in hand, to the Oude Turfmarkt and DNB’s Governing Board pledged to make 200 million guilders available for the fund. The immediate crisis had been defused, prompting a proud DNB President Vissering to write: ‘... We had suddenly become the central institution, around which everything was concentrated ...’

‘Slumbering old lady’

Due to the outbreak of the First World War, DNB’s first centenary celebrations were necessarily sober, but it was in those war years that DNB, in the words of President Vissering, was transformed ‘from a slumbering old lady into a very lively institution’. The bank was involved in financing the supply of goods; it assisted the government with grain purchases, and acted as one of the initiators of the Netherlands Export Company (NUM). DNB also played an essential role in a settlement system for Amsterdam-based banks, which would later gain national significance.

One hundred years earlier, when DNB was founded by King William I, it had by no means been anticipated that DNB would one day become the country’s central bank, but the bank featured prominently in King William’s plans for the country. Even before taking the oath on 25 March 1814, King William I had signed the decision comprising the Patent and Regulations for De Nederlandsche Bank. And the name he gave to the new institution also signalled that it was not intended to serve a specific section of the population, but the nation as a whole. In short, DNB was to be a national bank. In setting up the bank, the king was driven by: ‘the obligation resting upon us to revive Commerce, as the lifeblood of this State, from the slump brought upon it by earlier times and circumstances’.

William I was thus responding to the Republic’s degeneration at the end of the eighteenth century. The debt-crippled State had seen society’s belief in its ability to repay its financial obligations fade away. As a result, the State also suffered a loss of authority and could no longer muster the resources to maintain the Dutch merchant trading network. Towards the end of the eighteenth century, this led to the birth of the heavily French-influenced Batavian Republic, which was succeeded at the start of the nineteenth century by the Kingdom of Holland under Louis Napoleon Bonaparte. A full annexation by France followed in 1810, but this soon came to an end in 1814 when his brother Napoleon Bonaparte was forced to renounce the French throne.

Merchant King

The future rested in the hands of King William I, who launched an industrialisation policy in a bid to break through the obsolete trading structure of the seventeenth and eighteenth centuries. His efforts were only partly successful, but the dedication and perseverance he brought to the task earned him the honorary nickname of Merchant King. The foundation of DNB was an expression of his entrepreneurial drive. Uniquely, DNB acted both as a credit institution and as a circulation bank, i.e. a bank authorised by the government to issue banknotes.
This was the key distinction between DNB and the Amsterdam Exchange Bank (Amsterdamse Wisselbank), which was set up in 1609 by the City of Amsterdam to end the chaos in the payment system caused by the use of hundreds of different officially recognised coins. Merchants could entrust their gold and silver pieces to the new Exchange Bank in return for a credit (or deposit) in the bank’s books. In exchange, they received a hand-written receipt, a ‘bill of exchange’ with which they could also pay their creditors. In addition, the Exchange Bank provided giro payment services, enabling the rich to make money transfers to third parties, and it started extending loans to the Dutch East Indies Company, the States of Holland, and the City of Amsterdam. After its initial success as one of the engines that propelled Amsterdam to pre-eminence as the world’s economic and financial capital during the Golden Age, the Exchange Bank gradually lost momentum and faltered. Unlike similar institutions elsewhere, such as the Riksbank founded in Sweden in 1668, it never developed into a circulation bank. Meanwhile, the Republic sank into economic decline and the once-dynamic city of Amsterdam languished in stagnation. In 1820, the Exchange Bank closed its doors, six years after the inception of DNB. The new bank was not granted a monopoly on the issuance of banknotes, but it was protected against competitors thanks to an exemption from stamp duty on its banknotes. Furthermore, copying DNB notes was made a criminal offence.

Still, DNB got off to a rather difficult start. In the first decades after its inception, its economic influence and geographical reach were limited and largely confined to Amsterdam. Nevertheless, its first financial year was fairly successful: in 1815 DNB paid out a dividend of 5.8%. However, the issuance of five thousand shares initially met with a lukewarm response and attracted few subscribers among Amsterdam’s haute financiers. The bulk of the share capital, five million guilders, was contributed by the King and the State. In 1816, barely two-thirds of the five thousand bank shares issued had been sold. Banker’s widow and businesswoman Johanna Borski (1764-1846) came to the rescue in 1816 by agreeing to buy the last 1,892 shares at a price of 101%, on the condition that DNB’s authorised capital would not be allowed to increase during the first three years. The scarce shares shot up in value, not least thanks to the high dividend (over 10% in 1819), enabling Johanna Borski to sell her shares at a huge profit.

In the second half of the nineteenth century, DNB finally became the national bank that William I had envisaged from the outset. The catalyst was the newly flourishing economy, which boosted demand for credit. DNB occupied a strong position as a lender as it held large stocks of precious metal. As a result, it was able to meet the accelerating demand for credit, which was much more difficult for the banking houses.

A pivotal figure in DNB’s rise to prominence was William C. Mees, a banker’s son from Rotterdam, who started at the bank as company secretary in 1849 and then served as its President from 1863 to 1884. Mees had outspoken views about DNB’s role, which he thought should focus first and foremost on serving the public interest. As part of this effort, he also sought to make the institution more transparent through the publication of monthly figures on the circulation of banknotes, the current account and precious metal holdings. DNB’s lending powers were also expanded because, as Mees explained, it was necessary ‘to set the Bank’s credit to work much more boldly than before’.
‘Paternal supervision’

The Bank Act (Bankwet) of 1863 provided DNB with national status and it was given the task of opening agencies throughout the country. At least one agency was established in each province, while the economically powerful city of Rotterdam was given a Branch Bank that was authorised to perform the same services as the head office in Amsterdam. In addition, correspondent agencies were set up in smaller regional centres, which operated on a commission basis. In satisfying the regional demand for credit and money, the extensive branch network was instrumental in galvanising economic growth, prompting some historians to speak of an ‘industrial revolution with a Dutch signature’.

The economic resurgence also stimulated the advent of private banks at the end of the nineteenth century. DNB’s traditional customers, including businesses, switched over to these private banks to benefit from their broader range of services. These, in turn, came to DNB to rediscount their customers’ paper and to take out loans using their securities as collateral. This enabled the private banks to substantially expand their lending operations. DNB gradually saw its role shift from a lender to businesses to a lender to banks, a process that was completed in the twentieth century.

A crucial side effect of this new role was that DNB required insight into the creditworthiness of its bank customers. They were required to submit information on the ratio between lending and capital, as well as to provide reports in the form of monthly statements. This was the prelude to DNB’s future role as supervisor. However, pending the formal acceptance and legal confirmation of its supervisory status, the arrangements were initially confined to an informal type of ‘paternal supervision’.

Bank run

DNB gained in national stature in 1914 when it managed to avert a bank run at the outbreak of the First World War. In the 1920s, it became clear that a number of banks had lent too much against insufficient collateral. Some went bankrupt, others needed to be restructured. In some cases, DNB acted as ‘lender of last resort’ or forced the banks to undergo radical reorganisations. The aim was to prevent a domino effect of collapsing banks leading to a full-blown financial crisis. The successful containment of the looming crisis further strengthened DNB’s status as a national bank during the interwar period.

The Bank Act of 1948 assigned even greater powers and responsibilities to DNB, which was officially proclaimed guardian of the guilder. Pursuant to Section 9(1) of the Act, its task was to: ‘...regulate the value of the Dutch currency in the manner that best serves the country’s welfare and prosperity, while keeping that value as stable as possible ...’ As the only bank authorised to issue banknotes, DNB had effectively fulfilled this role since its incorporation in 1814. However, until the middle of the nineteenth century this role was less visible as coins still accounted for the lion’s share of monetary transactions in the Netherlands. When it became clear that DNB held sufficient liquidity in coins and coinage metals, the public started to place more trust in the banknotes issued by the bank. Consequently, the share of banknotes in the total money supply grew steadily after 1850. DNB’s monetary policy evolved as a result: following the introduction of the silver standard (1847–1875) and the gold standard (1874–1914 and 1925–1936), the metallic money system came to an end in 1936. Banknotes were no longer exchangeable for gold and the acceptance of paper money became a question of trust. Like many other countries,
the Netherlands opted to influence the economy by more closely coordinating its monetary and socioeconomic policies. This was the chief underlying reason for nationalising DNB in 1948 and entrusting it with an exclusively public task aimed at promoting welfare and prosperity in a broad sense.

**Power to overrule**

The nationalisation had profound consequences, also for DNB’s relationship with the government. As a measure of last resort, the government was empowered to overrule the bank and issue an instruction ‘... for the coordination of the government’s monetary and financial policy and the bank’s policy ...’

The power to overrule, as laid down in Section 26 of the Bank Act, was an ultimate remedy in the eyes of its initiator, Finance Minister Pieter Lieftinck. The intention was that the implications of using it would be so daunting that both the minister and the central bank president would do everything in their power to ensure it was never activated – and this is how it remained until the introduction of the new Bank Act of 1998.

Central bank president Marius Holtrop in 1964 expressed the relationship between the Dutch State and DNB as follows: ‘The ship of State has only one captain, being the government. But the legislator has (...) prescribed that in the choppy waters of monetary policy, the ship of State must use the services of a marine pilot. That pilot is De Nederlandsche Bank. An experienced captain trusts his pilot, but as every sailor knows, the captain always remains responsible, even when the pilot is navigating the ship.’

The records show that the closest the government ever came to overruling the bank was in 1975 when central bank president Jelle Zijlstra flatly refused to use direct monetary instruments to finance spiralling public expenditure. Prime Minister Joop Den Uyl commissioned a study into the conditions under which he could overrule DNB. In the end, the government backed down because of the tremendous authority that Zijlstra enjoyed in the Netherlands as a former Finance Minister and former Prime Minister. His successor, Wim Duisenberg, was also aware of his powerful position. Commenting in an interview on his relationship with Prime Minister Ruud Lubbers, he observed: ‘Lubbers is the Prime Minister, but I am the President’ – a tongue-in-cheek remark, perhaps, but it conveys the delicate balance of power and division of roles between the government and the central bank at the time.

**Act on the Supervision of the Credit System**

Under the Bank Act of 1948, DNB was also responsible for circulating banknotes, facilitating funds transfers and promoting cross-border payments. A further task consisted of the supervision of credit institutions. Initially an unofficial task, this latter role was formally laid down in the Act on the Supervision of the Credit System (Wet toezicht kredietwezen – Wtk) in 1952. At first, a distinction was made in the supervision between socioeconomic and microprudential supervision.

Socioeconomic supervision gave DNB extensive powers to intervene at private banks. Among other things, these banks were not permitted to extend unlimited credit to consumers and DNB was authorised to intervene whenever their actions posed a threat to the stability of the currency. Microprudential supervision was aimed at ensuring that banks conducted their business in a careful and responsible manner and avoided taking unacceptable business risks. Even today,
bonds are only permitted to merge with or take a stake in other banks or insurers after DNB has issued a ‘declaration of no objection’.

Until well into the 1990s, microprudential supervision in the Netherlands was sector-oriented. DNB oversaw banks, investment firms and foreign exchange offices, while the Securities Board of the Netherlands (Stichting Toezicht Effectenverkeer – STE), which was set up in 1992, supervised listed investment firms and listed companies. The Pension and Insurance Supervisory Authority (Pensioen- en Verzekeringskamer – PVK) concentrated on pension funds and insurers. At the same time, the legislator and supervisors were beginning to recognise that the financial world was becoming increasingly intertwined, due to an ongoing process of both national and international mergers between institutions. Products, too, were becoming more complex. As a result, supervisors sometimes encroached on each other’s territory, which confused supervised institutions. To address this problem, the Council of Financial Supervisors (Raad van Financiële Toezichthouders) was set up in 1999 to discuss cross-sector supervisory issues.

**Merger between DNB and PVK**

Just three years later, it was agreed that a new supervisory approach was needed. DNB and the PVK were entrusted with prudential supervision, which monitors the health of financial institutions. The STE, in turn, became the Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten – AFM) and was made responsible for the supervision of business conduct at financial institutions. The AFM also kept an eye on how institutions communicate with customers and was given the ultimate responsibility for granting licenses to investment firms. A further step was taken in 2004 when the prudential supervisors, DNB and PVK, merged in accordance with a new single Act: the Financial Supervision Act (Wet op het financieel toezicht – Wft).

Despite the improvements made by means of the integration of the Dutch supervisory system, the collapse of the US merchant bank Lehman Brothers in September 2008 made it painfully clear that both supervision and legislation had failed to keep pace with global economic developments. In the 1980s, the English-speaking world had embarked on a process of liberalisation and deregulation, and many countries around the world had followed suit. This process had spurred the globalisation of markets and companies, leading to unprecedented innovation as well as greater prosperity.

**Stormy weather**

Due to the intertwining of markets, companies and products, the credit crisis took on the character of a full-blown systemic crisis. Hidden weaknesses in the supervisory framework came to the fore, such as low capital requirements and the absence of an international liquidity standard. In his 2011 book ‘Nout Wellink aan het woord’, former DNB President Wellink said: ‘In mid-September, Lehman Brothers collapsed. This caused an enormous shock, which reverberated right through the capillaries of the global financial system. ABN AMRO and Fortis soon found themselves in trouble, and Iceland was also battling the waves. Of course, you can try to pin the blame on any Tom, Dick or Harry at micro-level, but there was a common underlying cause. The foundations were a lot more brittle than we had realised (-).’
The profound shock of the credit crisis, as well as the ensuing criticism on microprudential supervision from society at large, prompted a period of serious self-reflection at DNB. This resulted in 2010 in the DNB Supervisory Strategy 2010-2014, a document setting out the bank’s conclusions and action points that were implemented in the following years. The general thrust of these action points was that supervision required a greater emphasis on the supra-institutional perspective than before.

DNB opted for a more forward-looking and supra-institutional perspective, as well as close coordination between macro- and micro-supervision. More attention is now devoted to the business model and strategy, and the conduct and culture of supervised institutions.

**Europe**

Meanwhile, there is also an unmistakable trend towards more international consultation, regulation and policy coordination. The credit crisis led to Basel III for banks and gave an impulse to the development of Solvency II for insurers. A further step will be taken at the end of 2014 with the transfer of the supervision of banks from the national supervisors to the ECB. The European banking union is created in response to the lesson learned from the credit crisis that financial institutions in Europe are (or can grow) so big that they become locked in a deadly embrace with government budgets. This, in turn, could jeopardise the financial stability of the entire euro area. To prevent this, a Supervisory Board will be put in place with far-reaching powers for the supervision of all 4,000 banks in Europe. A health check consisting of a comprehensive balance sheet assessment will be performed on the 130-odd most significant banks in Europe. At the same time, a European resolution mechanism, a European resolution fund and a European deposit guarantee scheme will be put in place.

The advent of European banking supervision, in the form of a Supervisory Board formally controlled by the Governing Council of the ECB, reflects the fact that supervision, financial stability and monetary policy are steadily growing towards Europe-wide consultation and decision-making. Interestingly, the trend towards pan-European monetary policy already started in the wake of the Second World War. The first step was taken at national level with the Bank Act of 1948, which designated DNB as ‘the guardian of the guilder’. This was soon followed in the early 1950s by initiatives to foster political cooperation at European level, starting with the foundation of the European Coal and Steel Community (ECSC) and the European Economic Community (EEC), culminating – in 1992 – in a common internal market with free movement of people, goods, services and capital. Parallel to this development, the idea for a monetary union arose in the 1960s. The first step was the ‘snake arrangement’, where the EEC countries sought to keep their currencies stable versus one another. This initiative foundered on the contrasting economic and monetary interests of Germany and the Netherlands on the one hand, and France and Italy on the other. In 1979, the snake arrangement gave birth to the French-German idea for a European Monetary System (EMS). Ten years later, in 1989, Jacques Delors, the then President of the European Commission, presented a follow-up proposal: the Economic and Monetary Union (EMU) and the introduction of a single European currency, the euro. In 1992, this plan was formally endorsed by the Maastricht Treaty.

In 1999, the long-awaited moment arrived when several European Union member states decided to set up an Economic Monetary Union. That year, the euro was
introduced (albeit only in electronic form) and the national currencies were pegged to the euro. The Netherlands, whose exports and prosperity depend strongly on European trade, wholeheartedly backed the move. However, the country’s participation necessitated a new Bank Act, which came into force in 1998. This stipulated that DNB would form part of the European System of Central Banks (ESCB). Among other things, this meant that the government would lose its right to overrule, but instead would have the right to demand ‘... data or information which, in its opinion, was necessary to determine the financial and economic policies of the government....’ Since 1 January 1999, monetary policy has been determined by the Governing Council of the ECB in Frankfurt. Its first president was Dutchman Wim Duisenberg.

Crowning achievement

The full Governing Council includes the presidents of the national central banks of all member states. Acting jointly, but in a personal capacity, DNB president Klaas Knot, his fellow central bank presidents and the members of the ECB Executive Board map out the course of European monetary policy, which the national central banks then implement. Between 1999 and 1 January 2002, there was a currency union with a common non-cash euro, but there was still no tangible common currency. On 1 January 2002, the first euro notes and coins reached the purses of the European citizens.

The single currency is the crowning achievement of a multi-decade historic effort, which strove to establish the free movement of goods, capital and labour in order to promote peace and security. The guilder, which boasts a history of almost 450 years (with DNB as its guardian for nearly two centuries), had to make way for this broadly-endorsed historical objective. This year, a new pillar is being added: in addition to monetary policy, the supervision of banks, which has been DNB’s statutory task since 1952, will be lifted to European level. Two hundred years after it was founded in 1814, the Amsterdam-based institution that first evolved into a national bank has now become a fully-fledged member of a truly pan-European institution.
2013 Chronology
2013 Chronology

January

- January: Pensions curtailed. The Ministry of Finance announces a series of measures to restore the funding of the pension system. DNB fulfils an advisory role in this process.
- January: National agreement on financial services supervision announced. The Council of State, the supreme administrative law court, rules that on 1 January 2013, the Dutch banking system must comply with the new EU regulations for financial services.
- January: Dutch banks partially redeem loans to the ECB. The Dutch banks redeem EUR 7.4 billion of their loans from the ECB.
- January: Resolution Committee on 1 January 2013.
- January: Resolution Mechanism.
- January: National agreement on financial services supervision announced. The Council of State, the supreme administrative law court, rules that on 1 January 2013, the Dutch banking system must comply with the new EU regulations for financial services.

February

- February: Curtailed pensions. The Ministry of Finance decides to curtail pensions in a bid to restore their funding.
- February: Resolution Mechanism.
- February: National agreement on financial services supervision announced. The Council of State, the supreme administrative law court, rules that on 1 January 2013, the Dutch banking system must comply with the new EU regulations for financial services.

March

- March: National agreement on financial services supervision announced. The Council of State, the supreme administrative law court, rules that on 1 January 2013, the Dutch banking system must comply with the new EU regulations for financial services.
- March: Resolution Mechanism.
- March: National agreement on financial services supervision announced. The Council of State, the supreme administrative law court, rules that on 1 January 2013, the Dutch banking system must comply with the new EU regulations for financial services.

April

- April: National agreement on financial services supervision announced. The Ministry of Finance, in consultation with DNB, decides to strengthen financial services supervision. DNB fulfils an advisory role in this process.
- April: Resolution Mechanism.
- April: National agreement on financial services supervision announced. The Council of State, the supreme administrative law court, rules that on 1 January 2013, the Dutch banking system must comply with the new EU regulations for financial services.
- April: Resolution Mechanism.
- April: National agreement on financial services supervision announced. The Council of State, the supreme administrative law court, rules that on 1 January 2013, the Dutch banking system must comply with the new EU regulations for financial services.

May

- May: Resolution Mechanism.
- May: Resolution Mechanism.
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June

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July

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August

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September

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October

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November

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December

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Accountability
5 Accountability

5.1 Introduction

In this chapter, De Nederlandsche Bank (DNB) reports on the main results achieved in 2013. The ways in which the macroprudential mandate and instruments are embedded in the organisation, along with the monetary response to the reduction in market tensions, are discussed in Section 5.2. The main developments and results of the core task of Supervision are summarised in the separate independent public body (ZBO) report. Section 5.3 examines how DNB incorporates corporate social responsibility (CSR) into its activities, while Section 5.4 explains why costs came out lower in 2013 than budgeted. Section 5.5 describes the organisation’s corporate governance and explains how DNB seeks to limit risks, while it also provides an overview of the key risks identified to date. Section 5.6, contains information on DNB’s investments and financial risks, and explains how monetary exposure fell considerably in 2013 as a result of a reduction in monetary policy credit operations. Section 5.7 describes the activities undertaken by DNB to communicate financial knowledge to the Dutch public and the technical assistance it offers to fellow central banks and supervisors in other countries. Lastly, Section 5.8 discusses DNB’s efforts to continue improving its operations. These include endeavours to further improve organisational efficiency by increasing the opportunities to work independently of place, time and device.

DNB’s Governing Board presented a new long-term strategy (Polaris) to the organisation in 2012. The Polaris strategy consists of a renewed mission, ten long-term ambitions and a strategic framework. The ambitions are as follows:

1. DNB is an influential bank in the European System of Central Banks (ESCB).
2. DNB is a leading institution in the area of financial stability.
3. DNB stands for efficient and robust payment and securities chains.
4. DNB’s supervision sets a benchmark and is authoritative.
5. DNB influences financial and economic policy in its preferred direction.
6. DNB makes full use of the synergy stemming from its combined role of central bank and supervisor.
7. DNB hires only the best people for all positions.
8. DNB has a modern information system and produces useful statistics for internal and external users.
9. DNB helps build trust in the financial system through consistent communication.
10. DNB has an effective governance model.

Sustainability plays an important role in DNB’s performance of its tasks, as outlined in Section 5.3 and reflected in the organisation’s mission: ‘DNB seeks to safeguard financial stability and thus contributes to sustainable prosperity in the Netherlands’. This refers to long-term, sustainable prosperity, based on
Accountability

sustainable economic, social and environmental factors. Restoring trust and confidence in the financial sector, in the euro and in DNB as a central bank and supervisor has top priority. DNB seeks to perform its core tasks as effectively and efficiently as possible and, wherever feasible, to integrate and embed sustainability into its operations and the performance of its tasks. Sustainability is consequently discussed on various occasions in this chapter, both with regard to the core tasks and to the operations.

Table 5.1 - DNB’s key figures

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
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<tbody>
<tr>
<td>Average number of employees (FTEs)</td>
<td>1,659</td>
<td>1,625</td>
</tr>
<tr>
<td>Capital and reserves</td>
<td>EUR 7.9 billion</td>
<td>EUR 7.8 billion</td>
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<tr>
<td>Total operating expenses</td>
<td>EUR 349 million</td>
<td>EUR 311 million</td>
</tr>
<tr>
<td>Carbon footprint per FTE</td>
<td>2.3 tonnes</td>
<td>3.3 tonnes</td>
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<tr>
<td>% women in total workforce</td>
<td>37.6%</td>
<td>37.4%</td>
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<tr>
<td>Sickness absence</td>
<td>2.88%</td>
<td>2.88%</td>
</tr>
<tr>
<td>Spent on training</td>
<td>EUR 5.5 million</td>
<td>EUR 5.4 million</td>
</tr>
<tr>
<td>- Per FTE</td>
<td>EUR 3,317</td>
<td>EUR 3,303</td>
</tr>
<tr>
<td>Overall employee satisfaction (survey score)</td>
<td>7.7</td>
<td>7.6</td>
</tr>
</tbody>
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§2 Results achieved in DNB’s core tasks

§2.1 Financial stability

DNB is responsible for overseeing financial stability in the Netherlands. In its Overview of Financial Stability (OFS), DNB sets out the risks to financial stability and recommends ways of limiting these risks. The issues it highlighted in 2013 included the potential impact of sustained low growth on credit quality, the risk of sudden increases in interest rates and the effect of the deposit funding gap on bank funding. Following on from the risk analysis in the OFS, operational supervision assesses whether risks at any individual institution require mitigating action (i.e. the ‘macro-micro link’, whereby macro risks are converted into micro action).

The risk analysis also forms the basis for certain specific examinations, such as the cross-sector thematic examination of interest rate risks that was carried out in 2013. In the OFS, DNB called on the Dutch banks to continue strengthening their capital buffers so that they remain on course to meet the Basel III requirements in a way that does not excessively restrict their lending operations, to make adequate provisions and to reduce their reliance on market funding. The sector made further progress in this respect in 2013, with the result that the banking sector recorded a higher Tier 1 capital ratio in the third quarter of 2013 than a year earlier, while also reducing its reliance on market funding. Banks have been making increased provisions for property-related loans since their risk management practices were assessed in the thematic examination of commercial property. Insurers, meanwhile, were instructed by DNB to be more cautious in their issuing of guaranteed returns. In order to incorporate guarantee-related risks and other future risks more effectively into the supervision of the insurance sector, DNB has urged the Ministry of Finance to introduce more risk-based and forward-looking elements into its supervisory framework. These elements
include an own risk assessment, the theoretical solvency criterion (TSC) and the requirement for institutions to seek approval for dividend payments if their solvency position drops below the TSC. New legislation that includes these elements came into force on 1 January 2014. The European crisis and the discussions of a banking union have highlighted the need for a transparent, harmonised type of bail-in mechanism (whereby shareholders and creditors also contribute to the rescue of a bank that is on the verge of collapse), as well as the importance of credible balance sheet assessments. These latter assessments have been started.

The Financial Stability Committee met on two occasions in 2013. This Committee, which is chaired by DNB President Klaas Knot, also includes representatives of the Netherlands Authority for the Financial Markets (AFM) and the Ministry of Finance. The Committee called on Dutch banks to be more transparent about their risks by applying the recommendations of the Enhanced Disclosure Task Force (EDTF) in their annual reports. It also discussed how best to structure the mortgage lending market so as to achieve greater long-term financial stability. The Committee welcomed the policy aimed at gradually reducing loan-to-value (LTV) ratios and also made recommendations for further standardisation of mortgage loans in order to make them more attractive to non-bank and foreign investors.

Various changes in the Bank Act (Bankwet) and Financial Supervision Act (Wet op het financieel toezicht – Wft) came into force on 1 January 2014, which explicitly assign responsibility to DNB for promoting the stability of the financial system. The entry into force of the Capital Requirements Regulation (CRR) and the implementation of the Capital Requirements Directive IV (CRD IV) mean that DNB will be able to deploy macroprudential instruments when performing this task. The CRD offers various opportunities in this respect, including increasing sectoral risk weightings, requiring a countercyclical capital buffer and imposing higher capital buffers on systemically important banks. In 2013, DNB was involved in drawing up legislation to embed these instruments at a national level and thus allow them to be deployed in practice. At an international level, DNB actively contributed to the effective structuring of macroprudential policy in various forums, including the European Systemic Risk Board (ESRB). In addition, DNB chairs the Instruments Working Group, which focuses on operationalising instruments and objectives. Details of this work were published in early 2014, prompting the ESRB to issue a public recommendation.

From a financial stability perspective, it is important to ensure effective intervention is possible if an institution unexpectedly encounters problems and, if necessary, to resolve the situation. Substantial progress was achieved in 2013 in the recovery and resolution plans for the largest banks as DNB started putting in place feasible and credible resolution strategies in liaison with the Ministry of Finance and the larger Dutch banks. Most efforts to devise resolution legislation have been made at a European level, with DNB supporting the Ministry of Finance in this respect and also helping to delineate the position of the European Central Bank (ECB).

The texts of the Bank Recovery and Resolution Directive (BRRD), which is the European bank resolution framework, and the Deposit Guarantee Scheme (DGS) Directive were completed during 2013 and will come into force within the foreseeable future. Towards the end of 2013, the Member States also agreed on a Single Resolution Mechanism (SRM).
5.2.2 Monetary tasks

As a member of the Eurosystem, DNB contributes to developing and implementing monetary policy measures aimed at promoting price stability, which is a precondition for sustainable economic development. Against the background of the European debt crisis, unconventional monetary policy continued to play a prominent role in 2013. Market tensions abated further during the year, as reflected, for example, in the early repayments on the longer-term (three-year) refinancing operations (LTROs). This was partly thanks to the ECB’s Outright Monetary Transactions (OMT) programme, which did not need to be activated in 2013 either. The extension of fixed-rate, full-allotment refinancing operations until at least mid-2015 means that banks in the euro area can count for the time being on the availability of virtually unlimited liquidity within the Eurosystem, providing they have sufficient collateral. Still, only politicians can take the measures needed to secure a sustainable solution to the problems facing the currency union, such as stricter and more enforceable budgetary rules, and structural measures to boost the euro area’s competitiveness and growth potential. Substantial progress was achieved in this respect in 2013, including the establishment of the banking union (see Section 1.4).

The euro area’s economic development remained extremely modest, although gradual signs of a cautious return to growth emerged in the second half of the year. However, inflation dropped below 1% during the year, and the ECB responded by reducing the policy rate in both May and November 2013. In order to provide the markets and the general public with more guidance on how the ECB Governing Council views the longer-term inflation outlook and the interest rate policy to be pursued, the ECB explicitly announced in July 2013 that it expected policy rates to stay at their current or a lower level for some time to come. In an environment of very low interest rates, many central banks are using forward guidance as a monetary policy instrument.

In addition to its monetary task, DNB also plays an advisory role in national and international policy debates and is therefore represented in various national and international platforms. Leveraging these contacts, its expertise and its independent position, DNB seeks to provide policy advice that promotes financial stability and sustainable prosperity through, for example, a stronger and more stable economic and monetary union (EMU). DNB also ensures its voice is heard in national policy debates, including the semi-annual economic forecasts. DNB has expressed its views on the need to consolidate public finances, and also contributed, in response to requests or otherwise, to the debate on other current issues such as the Dutch pension system and the country’s housing market. An example of DNB’s work in this respect can be seen in its involvement in the creation of the National Mortgage Institute.

DNB also increasingly plays a role in facilitating policy debate. In this context, it has arranged various meetings with national and international experts to discuss the roles of net and gross capital flows, labour market reforms in the EMU and the savings surplus in the Dutch corporate sector.

The economic crisis has raised fresh questions for economists and highlights the need to expand the range of policy instruments available to them. DNB has a responsibility to contribute to this academic challenge.

Consequently, DNB’s 2013 research programme once again devoted a good deal of attention to improving existing econometric models and developing new ones. In this context, the interaction between the financial sector and the real
economy is an important aspect, because the existing models have proved not to accurately reflect reality. This study has provided greater insight into the financial cycle and contributed to an operating framework for macroprudential policy.

5.2.3 Payments

Under the auspices of the DNB-chaired National Forum on SEPA Migration (NFS), stakeholders are working on the migration of the Dutch payment system to the European standard, the Single Euro Payments Area (SEPA). DNB is responsible on behalf of the NFS for ensuring the SEPA introduction proceeds smoothly and efficiently, while also enabling the payment system to continue functioning properly. In support of this aim, an IBAN promotion campaign was launched to make businesses and consumers aware of the changes involved in migrating to SEPA and to help them prepare. This campaign won two awards in 2013 for its communications (a SAN accent and a bronze Effie). Substantial progress was achieved in the SEPA migration in 2013. Whereas only 4% of credit transfers and under 1% of direct debits in the Netherlands complied with the European standards at year-end 2012, these figures had risen to 8% and 49%, respectively, by the end of 2013. This means that the Netherlands will not need to use the grace period to 1 August 2014 that has been granted by the European Parliament and the Council. Wherever necessary, however, banks will allow businesses and consumers to continue using the national payment infrastructure during this grace period.

DNB is seeking to enhance the banknote recirculation process in the Netherlands. To this end, banknotes that are suitable for re-use may now be recirculated by market players wherever possible. In a changing cash environment, banknotes are being recirculated through channels other than the traditional ones (i.e. banks and cash processors) and increasing numbers of retailers use banknotes from their cash takings to replenish cash machines. This is one of the reasons why forty million fewer banknotes were deposited with DNB in 2013 than in 2012 (2013: 530 million notes, 2012: 570 million notes). In 2014, DNB will continue its efforts to have as many banknotes as possible recirculated by market players. It will also conduct a pilot project in which cash processors will exchange suitable banknotes with each other, rather than the current situation where notes are deposited by one party at DNB, which then distributes them to the other party.

The increasing shift from physical to digital payments will also help improve the efficiency and security of payments, and this trend is expected to continue over the coming years. It is important, however, to continue devoting sufficient attention to the need to keep payment services accessible for vulnerable groups such as the elderly and people with a functional impairment, without internet access, with a low level of education or who are economically inactive. The need to maintain the accessibility of the payment system is one of the core tasks assigned to the National Forum on the Payment System (MOB), which is chaired by DNB and which sets out to promote the efficiency of the Dutch payment system. During 2013, MOB published its third Accessibility Monitor, in which it confirmed that the availability and accessibility of basic banking services remained good. Some very practical issues, such as the legibility of the new paper transfer forms and the position of telephone banking in the SEPA era, were resolved to the full satisfaction of the various groups represented on MOB.
As more and more people are doing their banking over the Internet, it is important to ensure that online banking systems and mobile banking apps are sufficiently accessible, and this is an area where there is still room for improvement. The MOB Working Group on Availability and Accessibility organised a thematic meeting in 2013 to improve banks’ awareness of this issue and is monitoring developments in this field.

MOB is also discussing the robustness of the payment system against the background of the DDoS (Distributed Denial of Service) attacks on banks, which resulted in the temporary unavailability of online payment services in April 2013. Its analysis of how the payment system can be made more resilient found that although the system as a whole is well protected, there are a number of individual aspects that can be improved. These are currently being worked on, and the measures taken will be assessed during 2014.

Another important aspect with regard to the robustness of the payment system is banknotes’ vulnerability to theft. Intelligent Banknote Neutralisation Systems (IBNS) are used to reduce this vulnerability as far as possible. These systems use ink, fire/smoke and bonding technologies to make banknotes unfit for use in the event of attempted theft. The most common application of these technologies is in dye-packs and ATM cassettes. Within the Netherlands Bankers’ Association (NVB), an Expert Pool comprising representatives of both DNB and the large banks is investigating the opportunities for using IBNS to prevent ram raids.

Box 1: Security versus accessibility

DNB regards the security of the payment system as essential. It is also important that the payment system remains accessible for everyone, including the vulnerable groups in society. The challenge here is to find an appropriate balance between security and accessibility. Greater security, for example, often results in reduced user convenience and higher costs. Banks aim to secure their payment systems in a way that has least impact on these systems’ accessibility and, in doing so, make use of various innovative solutions.

Substantial amounts have been invested in recent years in detection systems that can distinguish fraudulent transactions from legitimate ones without making any concessions in terms of accessibility. These investments have started to bear fruit: data published by the NVB show a reduction in the number of fraud cases.

The introduction of mobile banking is an example of an innovative technology that increases accessibility, while also incorporating various measures to improve security. It allows users to do their banking via an application (app) on their mobile phones, using a secret code. This means they can see the balance on their account and execute transactions anywhere and at any time. Its simple interface makes mobile banking highly accessible. Users can also activate a voice-over that reads out menu options. In order to make mobile banking secure, transaction limits are set and the security is linked to recently used account numbers. Neither measure obstructs users wishing to perform the most common transactions, but both reduce the risk of criminals committing fraud.
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5.2.4 Supervision

A healthy, strong and sound financial sector is able to absorb shocks and anticipate changing circumstances. Adaptability is a vital element of a robust financial sector and a shock-resilient financial system. The ability of the Dutch financial sector to adapt remained under pressure throughout 2013. The need to adapt stemmed not only from the continued lack of strong economic recovery, but from the implementation of laws and regulations which also demanded considerable efforts from financial institutions. The financial sector also has to contend with the new social reality, in which restoring society’s trust in the sector is proving to be a lengthy process. This issue was reinforced by the nationalisation of SNS Reaal and the manipulation of Libor.

The supervisory focus in 2013 was primarily on restoring buffers and balance sheets, on managing financial and economic and integrity risks, on preparations for banking supervision at a European level and on implementing supervisory requirements as well as requirements driven by legislation and regulations. However, explicit attention was also devoted during the year to the quality of governance and the viability of business models.

The aspect of international supervisory policy introduced in 2013 that will have most impact was undoubtedly the European Parliament’s adoption of the Regulation establishing the Single Supervisory Mechanism (SSM). Under the SSM, the ECB will be responsible from 4 November 2014 for supervising over 3,000 banks (consolidated figure) in the euro area. The SSM regulation also entrusts the ECB with responsibility for direct supervision of the 124 significant banks. Direct supervision of less significant banks on a day-to-day basis will still be carried out by the relevant national competent authorities (NCAs), but the ECB can give direction and, if necessary, take charge. DNB was closely involved over the past year in preparing for the SSM and European banking supervision. This included involvement in a detailed charting of the European banking landscape, drafting a legal basis for the SSM, large data requests for the ECB and preparing an Asset Quality Review (AQR).

The reporting year was also dominated by the implementation of the various supervisory requirements and the requirements resulting from legislation and regulations. The focus for banks was very much on the global Basel III agreement and its transposition into European legislation through the CRD IV/CRR rules. The requirements imposed by Basel III include significantly stricter capital and liquidity buffers. Considerable time was spent during the past year on examining how the Basel III migration plans can be used as the basis for providing guidance to ensure banks comply promptly with the new rules. Insurance companies also made significant progress during the year on preparing for the introduction of Solvency II on 1 January 2016. The transition to Solvency II represents a fundamental advance on the current framework because, for example, it introduces risk-based capital requirements. In liaison with DNB, the Ministry of Finance decided in 2013 to make the Dutch supervisory framework for insurers more risk-oriented and more forward-looking from an earlier date. These new rules came into force on 1 January 2014 and will further improve DNB’s ability to effectively supervise the sector. During the year, the pension sector also took major steps towards establishing a more sustainable pension system. These included the Pension Fund Governance (Further Measures) Act (Wet versterking bestuur pensioenfondsen – Wvbp), which took effect during the year, and a detailed review of the Financial Assessment Framework for pension funds. DNB was intensively involved in advising the Ministry of Social Affairs and Employment on both these developments during the year.
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In addition, the consequences of the nationalisation of SNS Reaal were monitored as part of DNB’s operational supervision. In early 2013, DNB and the Ministry of Finance had been forced to conclude that no public-private solution was available that would satisfactorily reinforce SNS Reaal’s capital position. DNB consequently advised the Minister of Finance to use the opportunities offered by the Intervention Act (Interventiewet) to secure the vital functions of SNS Reaal and the interests of savers and policyholders. In doing so, it explicitly took account of the interaction between macroeconomic aspects, financial stability and the supervisory measures to be taken in respect of SNS Reaal. Since the nationalisation, DNB has remained closely involved in developments relating to SNS Reaal, including the restructuring plan required by the European Commission. DNB was appreciative of the report that was published by the ENS Committee on 23 January 2014. This committee was set up to assess the nationalisation of SNS Reaal and one of its main conclusions was that the nationalisation was unavoidable. DNB has taken due note of the committee’s recommendations and will consider the recommendations for DNB’s governance structure in the discussions to be held on changes in the division of banking supervision responsibilities following the establishment of the European banking union. Consideration will also be given in that respect as to how best to structure and further reinforce the link between macro- and microprudential supervision.

Operational supervision in 2013 also targeted the investigation into Rabobank’s possible involvement in irregularities relating to the Libor and Euribor submission process. This investigation started in January 2012 and DNB identified a serious breach of the rules for sound and ethical business operations during the period studied. In response to this breach, Rabobank introduced a series of measures in liaison with DNB in order to reinforce its business operations. Alongside various change programmes relating to culture, conduct and compliance, action was taken to reinforce Rabobank’s risk management.

Lastly, during the year DNB actively sought to identify opportunities to make the effects of its supervision more visible. By clearly accounting to society for its supervision, DNB can promote trust and confidence in the Dutch financial sector. This means placing greater emphasis on impact measurement. In 2012, DNB defined four ambitions for its supervision of the financial sector, with a set of key performance indicators (KPI) for each ambition. The first measurements of these KPIs in 2012 led to various changes in 2013 to tighten up the measuring and reporting process (the results are set out in the 2013 ZBO report). External stakeholders were also consulted and reported that DNB’s supervision had become more in-depth and tenacious. This is important for DNB to know as it is one of the objectives of the projected change of organisational culture. At the same time, however, the financial sector is exceptionally dynamic, which means that DNB will continually have to adapt its supervision in response to relevant developments. This is reflected in DNB’s new Supervisory Strategy 2014-2018, in which DNB sets out its ambitions for the financial sector and various new focal points for its supervision. This new Supervisory Strategy builds on the route mapped out in the previous Supervisory Strategy in 2010. More information on the results, governance, risk management, efficiency and legitimacy of supervision in 2013 can be found in the 2013 ZBO report.

Sustainability in supervision

As far as DNB’s supervision is concerned, sustainability includes taking account of stakeholders’ interests in decision-making, as well as maintaining transparent policy and conduct, and a long-term perspective. Corporate social responsibility (CSR) is incorporated into supervision in the way DNB assesses how institutions...
comply with their non-financial requirements, specifically what is required of them in terms of integrity, strategy, business models, governance, conduct and culture.

Sustainability is also a factor in the assessment of whether financial institutions’ policymakers are fit for appointment; in other words, whether they are able to independently assess the interests of all stakeholders within their governance responsibilities. The integrity of institutions and their employees must be beyond reproach if society is to have trust and confidence in the financial sector. DNB’s integrity supervision in 2013 focused on examining whether financial institutions proactively sought to prevent corruption and the facilitating of corruption. Explicit attention was also devoted to identifying any involvement of supervised institutions in money laundering and the financing of terrorism (see Section 2.2 of the 2013 ZBO report).

Taking stakeholders’ interests into account means institutions must be transparent about their governance, strategy, objectives, policy and results. By explaining and being accountable, institutions enable stakeholders to verify how their interests are taken into account and to respond accordingly. The long-term perspective is reflected in DNB’s supervision of institutions’ business models and strategies, their remuneration policies and their conduct and culture. This supervision of business models and strategy involves focusing specifically on institutions’ long-term sustainability. Their remuneration policies must be in line with their strategy and long-term results and should not encourage excessively high-risk behaviour as this may jeopardise the sustainability of the institution’s results and its continued existence in various ways. Lastly, DNB’s supervision of conduct and culture seeks to encourage policymakers to reflect on their own performance and on how their decisions take account of the long-term outlook for the business and stakeholders’ interests. In 2013, following on from its earlier investigations of conduct and culture at banks, insurers and pension funds, DNB investigated five institutions at which it had previously identified high-risk conduct. These investigations found that the institutions in question had taken due account of the aspects previously identified and were following up appropriately. During 2013, DNB also conducted new investigations of the interaction between conduct, organisational culture and integrity at various institutions, including trust offices. Its findings resulted in the issuance of a series of general sector-wide recommendations for supervised institutions, as well as the creation of a self-assessment model for institutions (see Section 2.2 of the 2013 ZBO report).

5.2.5 Statistics

The statistics function supports DNB and the ESCB in performing their primary tasks. Fast, high-quality and easily accessible information is consequently becoming increasingly important, both in respect of supervisory data and the data DNB collects in support of its monetary and financial stability policies. These activities were expanded in 2013 to include the preparatory work needed to ensure compliance with the SSM, which assigns a central role to the ESCB’s statistics function. The reporting frameworks for banks were also changed to comply with the new European supervisory requirements (CRD IV) from the start of 2014. Substantial progress was made during the year in overhauling DNB’s statistics systems and, particularly, in providing supervisors with improved access to data on banks, pension funds and insurers. The ESCB also revised its statistics regulations to accommodate the data requirements arising from the new macroeconomic manuals of the IMF (BPM6) and the UN (SNA2008),
as well as those of users in the fields of financial stability and payments. Preference must increasingly be given to a more intricate system of data collection in order to ensure a flexible response to rapidly changing demands for information in the future. Such a system may include the individual loan data that are often available elsewhere in centralised credit registration systems. Another aim of the statistics function is to ensure that market parties and the general public receive information promptly. Therefore, during the year DNB published new tables on securities ownership as part of its efforts to comply with all SDDS Plus requirements, a new IMF statistics standard for countries with systemically important financial sectors. It also improved the accessibility of its statistics by, for example, adding interactive graphs. A strategic European Statistical Forum, in which the Netherlands is represented by Statistics Netherlands (CBS) and DNB, has been set up in order to continue meeting the increasing European requirements for statistics.

5.3 Corporate Social Responsibility

DNB used the output of its stakeholder dialogue on Corporate Social Responsibility (CSR) as input for further tightening of its policy and for determining its priorities in this area. DNB’s CSR policy consists of five themed areas: CSR in core tasks, the environment, sustainable procurement, social policy and social commitment. Each of these areas includes a number of topics, or spearheads, for which annual and medium-term objectives are set. The extent to which these objectives have been achieved is reported annually. More information on the CSR policy and how it is accounted for in this report can be found in the CSR Annex on DNB’s website.

5.3.1 Stakeholder dialogue

DNB seeks to ensure its stakeholders are closely involved in the performance of its primary tasks. To this end, it periodically holds an open and structured stakeholder dialogue with parties such as supervised institutions, the Ministry of Finance, the Ministry of Social Affairs and Employment and the AFM, its fellow supervisor. For more information, see the CSR Annex in the 2013 Annual Report. This dialogue covers both policy and the use of resources.

Between October and December 2013, DNB conducted a stakeholder dialogue in the form of a questionnaire, a feedback session and a series of interviews specifically focused on its CSR policy. The interviews concentrated on DNB’s CSR policy and how this is accounted for in the Annual Report. The materiality analysis (see Figure 5.1) reflects the outcome of this dialogue. DNB’s stakeholders are the people and organisations that work with DNB or that attach importance to the work, role and influence of DNB as a public institution with a social task. Its stakeholder dialogue includes representatives and policymakers from stakeholder groups such as supervised institutions, the government, the Netherlands Court of Audit, state-owned entities, NGOs (such as Eerlijke Bankwijzer), the Global Reporting Initiative (GRI) and the OECD. The common element in the results of the dialogue is the stakeholders’ wish that sustainability becomes an integral and operational part of DNB’s various core tasks. DNB will consequently examine whether ESG (Environmental, Social and Governance) risks can be added to the risks that are included in DNB’s supervision, while also being aware of the need to take account of the European banking supervision frameworks and the demands that these will impose on capacity. According to its stakeholders, DNB should, in any event, ensure a clearer profile for CSR within its core tasks. As DNB is a public institution with a social task,
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sustainability is already embedded to a considerable degree in its core tasks. This is where DNB’s true added value for society is to be found, rather than in – albeit also important – operationally-related activities such as efforts to reduce the organisation’s carbon footprint and its policy on contributions and donations. DNB has consequently set itself the objective of incorporating sustainability more effectively into its accounting for the performance of its core tasks. This is why the previously separate sections on Accountability and Corporate Social Responsibility have been integrated into a single section (‘Accountability’) in this year’s Annual Report.

5.4 Development of costs

The costs attributed to DNB’s core tasks in 2013 amounted to EUR 347.2 million (see Table 5.2). With the exception of the costs for monetary stability and economic advice, the costs of performing the core tasks were higher in 2013 than in 2012. The sharpest cost increases occurred in the Supervision and Payment operations. The increase in the costs of Supervision in 2013 was largely attributable to the expansion in capacity required as a result of the new supervisory model Focus! and the new supervisory category of investment institutions (Alternative Investment Fund Managers – AIFM). The increase in the case of Payment operations was the result of higher costs for banknotes and certain non-recurring costs relating to SEPA preparations (see DNB budget for 2013).

Explanation of variance between actual and budget for 2013

Total costs came out EUR 16.4 million below budget, with much of this underspend attributable to various DNB-wide developments. As in previous years, efforts were made to focus on the costs of support tasks. A further EUR 3 million
was attributable to lower salary costs (EUR 2.4 million) and lower pension charges (EUR 2.6 million). Other material differences in each core task are discussed below.

The budget overspend of EUR 3 million on Financial stability was attributable to higher ICT spending relating to preparations for the deposit guarantee scheme.

Over half (EUR 1.6 million) of the EUR 2.8 million underspend on Monetary stability and economic advice was attributable to developments affecting DNB as a whole. In addition, a number of policy departments decided in 2013 not to fill all their vacancies in anticipation of the efficiency objectives set for 2014.

In addition to developments affecting DNB as a whole (EUR 1.6 million), the total underspend of EUR 3.0 million for Payment operations was largely attributable to the decision to defer a project to improve the provision of information in the cash business from 2013 to 2014 as a result of reprioritisation within DNB (this accounted for around EUR 1.0 million of the underspend).

The costs of the core task of Supervision came out EUR 9.1 million lower than budgeted, with EUR 7.7 million attributed to lower staff costs. These costs are largely determined by the deployment of examining officers (i.e. FTEs in direct supervision). A capacity increase of around 10% had been budgeted for 2013 in view of developments such as the new supervisory model Focus!. As this increase was phased in over the course of 2013, average staffing levels for the year as a whole were around 29 FTEs lower than budgeted, which explains the underspend in the Supervision divisions. This underspend was expected and announced in the 2012 ZBO report. By the end of 2013, more or less all the staff vacancies had been filled and the planned capacity increase achieved. Some of the underspend on staff costs was also due to the positive factors referred to above and affecting DNB as a whole. The separate ZBO report provides a detailed overview of the development of costs within the core task of Supervision (see www.dnb.nl).

The costs associated with the Financial Expertise Centre (FEC) were EUR 0.3 million below budget, largely because of savings on staff costs.

Table 5.2 - Costs per core task
EUR million

<table>
<thead>
<tr>
<th>Core task</th>
<th>Actual 2013</th>
<th>Budget 2013</th>
<th>Variance</th>
<th>Actual 2012</th>
<th>Actual 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial stability¹</td>
<td>16.3</td>
<td>15.9</td>
<td>0.3</td>
<td>14.2</td>
<td>15.0</td>
</tr>
<tr>
<td>Monetary stability and economic advice</td>
<td>54.9</td>
<td>57.8</td>
<td>-2.8</td>
<td>56.4</td>
<td>57.4</td>
</tr>
<tr>
<td>Payment operations</td>
<td>110.2</td>
<td>113.1</td>
<td>-3.0</td>
<td>78.6</td>
<td>83.2</td>
</tr>
<tr>
<td>Supervision (excl. FEC)</td>
<td>139.9</td>
<td>149.0</td>
<td>-9.1</td>
<td>127.6</td>
<td>118.1</td>
</tr>
<tr>
<td>FEC</td>
<td>0.9</td>
<td>1.2</td>
<td>-0.3</td>
<td>0.8</td>
<td>1.0</td>
</tr>
<tr>
<td>Statistics</td>
<td>25.0</td>
<td>26.6</td>
<td>-1.6</td>
<td>23.8</td>
<td>27.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>347.2</strong></td>
<td><strong>363.6</strong></td>
<td><strong>-16.4</strong></td>
<td><strong>301.4</strong></td>
<td><strong>302.4</strong></td>
</tr>
</tbody>
</table>

¹ Including costs of operating DGS.
Spending on the core task of Statistics was EUR 1.6 million lower than budgeted. In addition to savings in the area of salary developments, this underspend largely related to lower staff costs and lower-than-anticipated depreciation and amortisation.

**Efficiency and legitimacy**

DNB strives to ensure its spending is completely legitimate. Consequently, its planning and control (P&C) cycle includes a specific link between the objectives of DNB and the related costs incurred. DNB has instructed the external auditor to assess the efficient and legitimate use of financial resources and to give an account of this in the auditor’s report, which is included in the report on the role of DNB as an independent public body. This also ensures compliance with DNB’s obligations under the Financial Supervision Act and the Pension Act (Pensioenwet). The indicator used to measure DNB’s efficiency is the extent to which its P&C cycle operates properly.

The internal standard is a legitimacy rate of 99%. The percentage achieved in 2013 was 99.4% (2012 and 2011: 99.2% and 99.4%, respectively).

### 5.5 Corporate governance and risk management

#### 5.5.1 Corporate governance at DNB

DNB is a public limited company incorporated under Dutch law. As a central bank, DNB forms part of the European System of Central Banks (ESCB). DNB President Klaas Knot is a member of the Governing Council and the General Council of the European Central Bank. As a supervisor, DNB has the status of an independent public body (zelfstandig bestuursorgaan – ZBO).

DNB is managed by a Governing Board, which is made up of the President and four Executive Directors. One of the Executive Directors, Jan Sijbrand, also chairs the Prudential Supervision Council for Financial Institutions and, in this capacity, has primary responsibility for supervisory policy. The Governing Board is supported by a company secretary and deputy secretary as well as the secretariat.

The Supervisory Board currently comprises eight members. It oversees the general operations of DNB and the policy of the Governing Board in implementing Section 4 of the Bank Act 1998. The Supervisory Board is also responsible for adopting the annual report. It has a number of important powers, such as the right to approve the budget and certain Governing Board resolutions. One member of the Supervisory Board is appointed by the government.

The Bank Council acts as the Governing Board’s sounding board. The President of DNB reports to this body on general economic and financial developments and on the policy pursued by DNB. The Bank Council comprises thirteen members. Two members of the Supervisory Board, including the government-appointed member, serve on the Bank Council. The aim in respect of the other members is to ensure that the Bank Council includes representatives of various parties in civil society.

More information on DNB’s governance structure can be found on DNB’s website, where institutional documents such as the Articles of Association, the Rules of Procedure and the regulations on integrity are also posted.
Dutch Corporate Governance Code

Although the Dutch Corporate Governance Code (the Code) applies only to listed companies, DNB applies its principles and best practice provisions as far as possible. A table clearly showing how DNB implements the Code can be found on DNB’s website.

5.5.2 Risk management

In 2013, the Governing Board adopted a risk management framework and an integrated risk management policy. This risk management framework creates a framework for a joint approach to risk management within DNB. By bringing all the risk management activities together within this framework, and viewing these activities and the identified risks as an integrated whole, the risks to which DNB is exposed can demonstrably be managed more effectively. The risk management and control systems are reviewed periodically. DNB seeks to comply with the applicable laws and regulations governing supervised institutions and to implement progressive insights. This basic principle has resulted in the establishment of a more cohesive, effective and integrated risk management system within the DNB organisation. One of the principles here is that risks should be addressed in a consistent manner, but that risk management can be applied in a differentiated way across the various parts of the organisation.

The Governing Board and divisional directors receive a quarterly management report on the status of and developments in the key risks facing DNB in general and those facing individual divisions in particular. The governance structure of DNB’s risk management is based on the three lines of defence model. These three lines of defence – line management, supporting risk management and control functions, and the internal audit function – operate independently of each other, with each contributing to the quality of the risk management and control system. The Governing Board is supported in this by bodies such as the Risk Management Committee (RMC), which advises the Governing Board on asset and liability management and associated risks. This includes the strategic investment policy, risk framework and buffers. The RMC also examines operational risks within the central bank activities, with a specific focus in 2013/2014 on the legal risk in contracts.

Management of specific risk types

DNB’s integral risk management and control system makes a distinction between strategic, financial and operational risk management. Its strategic risk management focuses primarily on managing DNB’s strategic ambitions. Financial risk management is described in Section 5.6. Operational risks comprise various risk types, including information security risks, process risks, business continuity risks, physical security risks, and compliance and integrity risks.

The purpose of information security is to assure the confidentiality, integrity and availability of information in a consistent and effective manner. In 2013, in addition to the continual monitoring by internal security experts, DNB introduced a coordinated approach to information security. This means that, from 2014 onwards, information security will be incorporated more integrally, efficiently and effectively into all relevant developments at DNB.

Risk management focuses on the entire process of identifying, analysing, managing and monitoring operational risks, with the aim of safeguarding controlled operations. Various methods and techniques are available to the organisation in this respect. Risk Self-Assessments (RSAs) at tactical and

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operational levels, as part of both business operations and individual projects, remain an important element of DNB’s operational risk management.

The purpose of business continuity management (BCM) is to coordinate measures to mitigate material and non-material loss as a result of a potential or actual crisis jeopardising the continuity of DNB’s processes. BCM risk management is at a mature level within DNB. The BCM policy was reviewed in 2013 as part of efforts to increase professionalism, while also taking account of the ESCB requirements and best practices applicable to the Netherlands’ core financial infrastructure.

Physical security at DNB focuses on aspects such as the security of individuals and buildings as well as the safe transportation of people, valuables and goods. In 2014, the General Intelligence and Security Service of the Netherlands (AIVD) will conduct an in-depth risk analysis, on behalf of the National Coordinator for Security and Counterterrorism (NCTV), to establish whether the various security measures in place, together with the government’s response capacity, are still adequate. Any recommendations resulting from this analysis will be followed up during the year.

The risk management system in the Compliance & Integrity (C&I) department focuses mainly on contributing to adequate management of the integrity risks and on preventing and mitigating losses resulting from actions contrary to internal and external laws and regulations, standards and codes of conduct. In 2013, C&I specifically targeted risks relating to the handling of information, outsourcing, outsourcing dependency and fraud.

Key risks
DNB faces some key risks in implementing its strategy, as described below:

1) The financial risks for DNB increased in 2012 in the wake of the financial and European debt crisis and the measures taken by the Eurosystem to control this crisis. Given the significant increase in risks, the Dutch State decided in early 2013, after consulting the Ministry of Finance, to issue a guarantee for DNB’s crisis-related exposures. A degree of risk remains, however, as not all the financial consequences of the European support packages are covered by the guarantee. DNB is closely monitoring developments and will take any action required.

2) Providing it is properly structured, the banking union represents an important step in restoring trust and confidence in the European banking sector. This banking union comprises three pillars: a single supervisory mechanism (SSM), a single resolution mechanism (SRM) and a single European deposit guarantee scheme (DGS). Recent indications from Brussels suggest that the resolution pillar may come into force shortly after the SSM. That is good news since, at minimum, a banking union needs to have mechanisms in place for both supervision and resolution in order to be effective. If supervision is organised supranationally, while resolution remains at a national level, conflicts of interest may arise and undermine the effectiveness of the supervision. The new European resolution authority will have substantial powers and a single European resolution fund (SRF) financed by the banks. The fresh resolution instruments will greatly reduce the chances that public funds will have to be used to rescue banks in the future. A number of important risks remain, however. The SRF, for example, comprises national compartments that will gradually merge into a single fund. The level of risk sharing during this transitional period is limited, which entails the risk that the negative feedback loop between banks and governments will not
be broken. A European public safety net will remain necessary, given the relatively limited target size of the SRF. Otherwise there is a risk that the safety net will ultimately remain national. The complex decision-making procedures proposed for the SRM also seem likely to obstruct effective action in an emergency. DNB will do everything in its power to achieve what it regards as an effective banking union.

3) The banking union has far-reaching implications for DNB’s prudential supervision of the Dutch banking sector as it will result in a situation whereby the supervision of systemically significant banks is overseen by Joint Supervisory Teams from the ECB in Frankfurt. These teams will comprise both local examining officers and officers of various other nationalities. DNB will continue to be responsible for supervising less systemically significant banks and has set up a project team to shape the new organisation and oversee this new method of working.

4) Violent crime is increasing, particularly within the cash sector. Preventing and mitigating the use of violence against DNB and its employees is a high priority within the organisation. To this end, DNB performs risk analyses on an ongoing basis and implements the resulting measures, while also maintaining an adequate level of physical and other security as well as sharing relevant knowledge and experience with agencies in the Netherlands and abroad. A security awareness programme has been introduced to make DNB staff aware of potential threats and controls. The screening procedures for both new and existing staff will be tightened up in 2014 so that possible vulnerabilities can be identified earlier.

5) Good security is obviously crucial if confidential information is to remain protected. DNB handles a great deal of confidential information. If this information should enter the public domain through theft (including cybercrime), loss or leakage, this could cause serious damage both to the organisation and other stakeholders. In order to prevent this, DNB is committed to ensuring its information security policy and procedures are up to date at all times.

Evaluation of internal risk management and control systems

The Governing Board evaluates the functioning of its internal risk management and control systems on the basis of reports from the planning and control cycle. These are used to establish the extent to which the divisions manage operational risks and implement appropriate measures to control those risks. The Governing Board also uses RSAs at a strategic level (in the divisions, chains and processes), as well as periodic reports from second-line functions and by the internal and external auditors.

In order to limit its financial reporting risks, the Board also assesses whether the processes and systems used for financial reporting are carried out in a sound manner. To achieve this, relevant information sources and statements by the owners of the relevant systems and processes are analysed.

The evaluation of the functioning of the internal risk management and control systems, any material shortcomings, significant changes and the key risks are discussed in the various meetings of the Audit Committee and subsequently reported to the Supervisory Board.

In control statement concerning financial reporting risks

Based on the evaluation it has carried out, DNB’s Governing Board declares that, with regard to the financial reporting risks in 2013, the internal risk management
Accountability

and control systems provide reasonable assurance that the financial reporting is free of material misstatement. The internal risk management and control systems in respect of the financial reporting risks operated satisfactorily in 2013.

5.6 Financial exposure

DNB’s financial exposure relates to its monetary operations, external reserves and the euro investment portfolio. Although the risk profile of the financial exposure improved during the reporting year, the risks generally remained high. The higher levels of trust in the European financial markets resulted in a fall in the exposure relating to monetary operations. In view of the high risk profile in these monetary operations, the risk profile in the management of the external reserves and the euro investment portfolio has expressly been kept low. Due to the drop in income from monetary operations and lower revenue from disposals of DNB’s own investments, the result for 2013 was considerably below the 2012 level.

5.6.1 Risks

The Securities Market Programme (SMP) exposures arising from the monetary policy and the monetary policy credit operations largely define DNB’s risk profile.

Monetary policy in the euro area is determined jointly by the central banks in the Eurosystem and the profits and risks are, in principle, divided among the national central banks in proportion to their share in the capital of the ECB. In the case of DNB, this share is 5.7%. DNB uses the expected shortfall (ES) method, with a one-year horizon and a reliability interval of 99%, and scenario analyses to calculate the size of the risks. The risk in non-investment grade countries is assessed using a stress scenario.

Total financial exposure from monetary operations, external reserves and the euro investment portfolio amounted to EUR 85.3 billion (see Table 5.3). The higher levels of trust in the financial markets resulted in a significant fall in the exposure. Although the risk profile of this exposure improved during the year, the risks remained high in absolute terms. The underlying risk (excluding gold) stood at EUR 13.5 billion as at year-end 2012 and fell to EUR 11.2 billion as at year-end 2013. This reduction is attributable to significantly lower tensions in the European financial markets, partly due to the recapitalisation of the Greek and Spanish banking sectors and the support provided to Cyprus. As the risk at year-end 2012 exceeded the capital buffer of EUR 7.8 billion, the Dutch State

<table>
<thead>
<tr>
<th>Table 5.3 - Financial exposure, risk and capital buffers</th>
</tr>
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<tbody>
<tr>
<td>Excluding gold, EUR billion</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Total exposure</td>
</tr>
<tr>
<td>Risk</td>
</tr>
<tr>
<td>Capital and reserves</td>
</tr>
<tr>
<td>Guaranteed exposure</td>
</tr>
<tr>
<td>Garantee</td>
</tr>
</tbody>
</table>
issued a five-year guarantee up to EUR 5.7 billion in early 2013. This guarantee solely covers DNB’s share in potential losses from crisis-related exposures. These exposures relate to the SMP and amounts owed by banks and national central banks in non-investment grade countries (Greece, Cyprus and Portugal). The exposures to which the guarantee applies fell from EUR 21.6 billion to EUR 17.4 billion during 2013, primarily as a result of repayments under the SMP and the recapitalisation of Greek banks. Although no losses were incurred on these exposures during the reporting year, the risk profile remains high.

In view of the high risk profile arising from its monetary policy tasks, DNB maintains a very low risk profile in its own investments. The interest rate risk on these investments is managed by capping the size and duration of the fixed-income portfolios. To manage the default risk on its investments, DNB applies a strict framework of limits for public authorities, issuers and banks. All bank exposure is backed by high-quality collateral. Most of DNB’s own investments are held in German Bunds and US Treasuries. The limited exposure to southern European countries decreased further during the reporting year as a result of bond redemptions. The default risk on the IMF receivable is hedged by a guarantee from the Dutch State. Forward exchange contracts are used to hedge the currency risks stemming from the investments in the US dollar, the Australian dollar and the IMF receivable in the form of Special Drawing Rights (SDR).

5.6.2 Monetary operations

The greater levels of trust in the European financial markets in 2013 resulted in a fall in the high level of exposure in DNB’s monetary operations. The improved market access for European banks translated into higher-than-expected repayments on the three-year VLTROs. This resulted in a significant fall in lending to financial institutions of EUR 22.4 billion to EUR 41.3 billion (see Table 5.4), with a majority of the early repayments from Spain and France. Nevertheless, the amounts drawn under the system at year-end 2013 were still high and were concentrated in Italy, Spain and Greece. Thanks to the recapitalisation, Greek banks regained access to open market operations (OMO).

DNB’s unconventional monetary policy includes programmes to purchase government bonds (SMP) and covered bonds (Covered Bond Purchase

<table>
<thead>
<tr>
<th>Table 5.4 - Exposure from monetary operations (excl. emergency liquidity assistance)</th>
<th>EUR billion</th>
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</thead>
<tbody>
<tr>
<td>Year-end 2013</td>
<td>Exposure from monetary operations (excl. ELA)</td>
</tr>
<tr>
<td>Greece</td>
<td>1.3</td>
</tr>
<tr>
<td>Cyprus</td>
<td>-</td>
</tr>
<tr>
<td>Portugal</td>
<td>1.0</td>
</tr>
<tr>
<td>Spain</td>
<td>2.2</td>
</tr>
<tr>
<td>Ireland</td>
<td>0.5</td>
</tr>
<tr>
<td>Italy</td>
<td>4.9</td>
</tr>
<tr>
<td>Other</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>9.9</strong></td>
</tr>
<tr>
<td>Year-end 2012</td>
<td></td>
</tr>
<tr>
<td>11.7</td>
<td>3.4</td>
</tr>
</tbody>
</table>
Programme – CBPP). In 2013, the total exposure in these portfolios fell by EUR 2.3 billion to EUR 12.8 billion as a result of redemptions (see Table 5.3). The 2012 announcement of the OMT programme marked the formal end of the SMP, while the purchases under the CBPP also ended in 2012.

5.6.3 External reserves and euro investments

The size and composition of the external reserves and euro investments (excluding gold) did not change in 2013. The external reserves and euro investments (EUR 47.0 billion, see Table 5.5) serve to support the Eurosystem’s common monetary policy and DNB’s financial stability objective. As a result, strict demands are placed on the credit quality and liquidity of the investments.

The main change in these exposures resulted from the sharp 30% fall in the gold price in 2013, which reduced the value of DNB’s gold holdings to EUR 17.2 billion. These holdings serve as an anchor of trust, and are also maintained for diversification purposes.

The bonds in the fixed-income portfolios are largely issued by governments, including regional authorities, and supranational institutions, and have short remaining terms to maturity. New guidelines for investments were issued in 2013, in consultation with the Minister of Finance and in accordance with Section 16 of the Bank Act. Under the revised investment guidelines, all the fixed-income euro portfolios – i.e. the euro, other financial assets and held-to-maturity portfolios – may be combined. Joint management will enable these portfolios to be managed more efficiently. In 2013, it was decided to reclassify the held-to-maturity portfolio based on mark-to-market valuation. This will allow active management to anticipate changes in the risk profile. The US dollar portfolio (EUR 6.9 billion) allows DNB to meet requests for currency from the ECB, the IMF and the Dutch State, while the Australian dollar portfolio (EUR 1.0 billion) is held in order to spread default risks more broadly.

The equity investments (EUR 1.6 billion), which are held for diversification purposes, had a good year. These investments are handled by three external managers, two of whom operate passive management policies and apply a benchmark based on regional MSCI indices. The benchmark for these passive equity investments was revised in 2013 as it was decided that there was no longer any need to deviate from the MSCI

<table>
<thead>
<tr>
<th>Table 5.5 Composition of the external reserves and euro investment portfolio EUR billion</th>
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<tbody>
<tr>
<td>External reserves and euro investment portfolio</td>
</tr>
<tr>
<td>Year-end 2013</td>
</tr>
<tr>
<td>Gold</td>
</tr>
<tr>
<td>Euro investment portfolio</td>
</tr>
<tr>
<td>American Dollar portfolio</td>
</tr>
<tr>
<td>Australian Dollar portfolio</td>
</tr>
<tr>
<td>IMF receivables</td>
</tr>
<tr>
<td>Equity investments</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
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World Index. The third external manager is a fund that pursues a responsible investment policy in line with the principles formulated by DNB. It is our ambition to apply the CSR policy to all our equity investments and we will continue efforts to achieve this ambition in 2014 through passive investments.

5.6.4 Results

In 2013, DNB recorded a profit of EUR 1.178 billion (see Table 5.6 and the financial statements). Income from monetary operations is a major component of the result. The decrease of EUR 326 million in this income item to EUR 942 million was attributable to repayments (early and otherwise) on these operations and lower interest income from monetary policy credit operations due to the reduction in the policy rate to 0.25%. The 0.25% narrowing of the difference between the interest rates on liquidity-providing and liquidity-absorbing operations also contributed to the lower result.

DNB’s own investments achieved a result of EUR 329 million, which was also significantly lower than in 2012. The fall of EUR 358 million was attributable to lower returns on the fixed-income portfolio. This was the result of lower interest rates on investments and lower realised gains on the revaluation accounts for fixed-income securities. Gains realised on the revaluation accounts in 2012 were high because of the shortening of the term to maturity of the portfolios. The sharp fall in the gold price in 2013 did not impact the result as this is charged to the gold revaluation account.

5.7 Financial education and technical assistance

5.7.1 Financial education

DNB has a fairly long tradition of providing information on the core tasks of a central bank and on the functioning of the broad economy. Its Visitors’ Centre provides information on these subjects to school pupils, students and other target groups. In 2013, the Centre welcomed around 17,000 visitors, mainly groups of school pupils. One other objective of DNB’s educational initiatives is

<table>
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<tr>
<th>Table 5.6 Breakdown of profit</th>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Monetary operations</td>
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<tr>
<td>OMO</td>
</tr>
<tr>
<td>CBPP</td>
</tr>
<tr>
<td>SMP</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>External reserves and euro investment portfolio</td>
</tr>
<tr>
<td>IMF receivables (SDR)</td>
</tr>
<tr>
<td>Participation in ECB and BIS¹</td>
</tr>
<tr>
<td>Sundry (incl. costs)¹</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

¹ More information on results from participations and sundries can be found in the financial statements.
to teach people to manage money responsibly and to take better financial
decisions. In addition to arranging exhibitions, it also provides materials such as
teaching packs, letters, brochures, films, online games, posters and comics.

In 2015, the Visitors’ Centre will be moving from the Achtergracht to the
Sarphatistraat building, which will be renovated and made accessible for
individual visitors. The renovation work and relocation present a good
opportunity to consider how we want to structure the Centre for the future,
and to consider which exhibitions to retain and which to redesign. It has
therefore been decided not to invest in the current exhibition space at the
Visitors’ Centre, with the exception of the investments made in 2013 in the
monetary policy section. This section’s new presentation on inflation and the
role of central banks (in the form of two animated films) has proved very
popular among pupils and students in secondary and tertiary education and
won an international Comenius EduMedia award in Germany in 2013.

DNB also participates in the Money Wise Platform (Wijzer in geldzaken),
which is an initiative of the Ministry of Finance. As part of this platform,
over forty partners from the financial sector, the public sector, the academic
world and public information and consumer organisations have joined forces to
help improve consumers’ financial awareness and education. DNB is one of the
four sponsors of this project.

In 2014, DNB will take part in the fourth national Money Week organised by
the Money Wise Platform. During this event DNB staff will give guest lectures
at primary schools with a view to teaching children how to handle money
better. DNB also supports Child and Youth Finance International (CYFI),
a worldwide foundation set up to promote financial awareness and skills among
children in more than one hundred countries so that they are better able to
manage their money and take better financial decisions. CYFI also helps to
improve children’s access to financial services around the world. As well as
providing moral support for CYFI’s objectives and participating in CYFI events,
DNB has made premises available to the CYFI organisation free of charge.

5.7.2 Technical assistance

The recent financial crisis has once again demonstrated the importance of
cooperation between central banks. This cooperation, which is also referred to
as technical assistance, is a stabilising factor and helps to build institutions,
while also improving institutional and staffing capacities and creating a platform
for exchanging information and establishing useful relationships. The technical
support DNB provides is especially targeted at central banks and supervisors in
the group of countries jointly represented in the IMF by the Netherlands and
Belgium. This IMF constituency comprises fifteen countries, primarily in the
former Yugoslavia and the former Soviet Union. These countries are still
developing and many of them continue to need assistance to reinforce their
resilience and long-term stability. The capacity devoted by DNB to technical
assistance in 2013 amounted to 760 days, equivalent to 3.8 FTEs (excluding cash
expertise). A further 1.6 FTEs were devoted to coordination, control and support,
taking the total to 5.4 FTEs. In early 2014, the Dutch government agreed for a
fifth year to sponsor the highly-reputed academic training programme that the
Duisenberg School of Finance developed at DNB’s request for central banks,
Ministries of Finance and supervisors in the constituency countries. A particular
feature of this programme is that central banks and ministries attend the same
workshop. This helps them improve their understanding of each other’s work.
and therefore also enhances the cooperation between central banks and governments. In 2013, DNB also provided assistance to countries such as Russia, Indonesia and Aruba, and participated in a technical assistance programme for Serbia operated by the Eurosystem.

Cash expertise
DNB’s payment experts are active in various groups, of changing composition, within DNB’s Cash Expertise Centre (CEC). The CEC makes its knowledge available whenever there is a national or international need for expertise in the areas of cash innovation, technical support or cash systems implementation. By sharing its expertise, DNB can also increase its own knowledge and improve processes within its own organisation. In that way, it helps promote an effective, secure and efficient payment system.

In 2013, the CEC was involved in developing a seminar to be held in 2014 for Asian central banks at the initiative of the central bank of the Philippines. During this seminar the CEC will give various presentations and workshops on subjects such as how to efficiently recirculate banknotes and on designing banknotes for the visually impaired. In 2013, the CEC organised a three-day workshop on cash management for a delegation from the Thai central bank that visited various areas of DNB’s cash activities. The Thai central bank was particularly interested in the implementation and functioning of the efficient system that DNB has put in place in the Netherlands for recirculating banknotes.

5.8 Operations

5.8.1 Effectiveness and efficiency
In 2012, the DNB Governing Board presented a new strategic plan (Polaris) to the organisation. This consists of a renewed mission and ten ambitions (see Section 5.1). In formulating these ambitions, the Governing Board has set the course to be followed in the coming years. This strategy will be reviewed whenever circumstances – such as the introduction of European banking supervision – require. Although other organisational goals will also be relevant in the years ahead, these long-term ambitions reflect the Governing Board’s focus areas. In the coming years, the regular planning and control cycle will be used to monitor progress towards achieving the specific targets that have been set as part of the ambitions, and to make any necessary adjustments.

In line with this multi-year strategy, various steps were taken in 2013 to enhance the effectiveness and efficiency of DNB’s operations. These steps included revamping communications, with the specific aim of reinforcing supervision and ensuring that DNB can communicate more effectively with society about supervisory issues as well as making more explicit use of communications as a tool for achieving effective supervision.

In addition, given the positive experience to date (see Section 5.8.2), DNB has decided to extend the training programme started in 2012 to attract highly talented staff. The newly established DNB Academy (see Section 5.8.2) is now responsible for coordinating the various in-house training initiatives.

Consideration is also being given, from an accommodation perspective, to how the divisions’ operations and processes can be better supported. One initiative involves the promotion of flexible working, resulting in fewer physical workplaces. From a cost perspective it was decided to dispose of DNB’s external
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The opportunities to work independently of place, time and device were expanded during the year, thus allowing employees to work more efficiently. As part of this process, work was started on modernising the ICT infrastructure and making it more flexible, for example by examining the opportunities for cloud computing and modernising DNB’s data storage facilities. In addition, DNB took action to further strengthen its procurement activities. The various improvements underway will continue in 2014.

As part of a campaign to curtail spending, all employees have been asked to come up with ideas to reduce costs and make operations more sustainable.

5.8.2 Employees

In DNB’s strategic plan (Polaris), human resources are seen as the most important tool for achieving the organisation’s objectives. One of these ambitions states that DNB wants to hire the best people for all positions. In addition to attracting highly talented people, DNB must also be able to retain them and provide development opportunities. All HR activities are aimed at making a contribution to this ambition. This is done by offering interesting, challenging work and sufficient opportunities for growth and development as well as promoting job rotation and training.

Focus on recruitment

All recruitment and selection activities were assigned to a single, centralised recruitment team during 2013 so as to make these activities more efficient, while also reducing the time it takes to recruit staff and to achieve a perfect match. For this latter purpose, dedicated recruiters focus on specific target groups, including new hires and economic, legal or actuarial specialists. The advantage of such a set-up is that the recruiters get to know their target groups increasingly well and so build up ever-larger networks. This, in turn, means they are better placed to recruit proactively and to identify the people best qualified for the position. This approach has proved successful in, for example, the expansion of the staffing capacity of the Supervision Divisions in 2013.

Traineeship programme

DNB held its second selection day for trainees in February 2013. The key aim of the traineeship programme is to recruit highly talented young people. Seven new trainees started work in seven different divisions on 1 April. These trainees emerged as the best candidates from a total of 226 applicants and several rounds of selection. Apart from the recruitment of highly talented young people, the traineeship programme also promotes cross-divisional cooperation through job rotation. In October 2013, DNB was awarded the 2013 prize and accompanying accreditation for the ‘Best starter traineeship programme in the Benelux’ at the annual Career Event held at the Utrecht Jaarbeurs exhibition centre. A new group of trainees will join DNB in 2014.

From Supervisory Academy to DNB Academy

In June 2013, it was decided to set up a DNB Academy. This academy will bring together the various existing DNB training programmes, including the Supervisory Academy and the Basic Central Banking Course. DNB Academy’s centralised management of these programmes will enable participants to expand their networks and exchange knowledge above and beyond the DNB divisions in which they are working. The curriculum will therefore, in any event, include modules common to all traineeships. It has also been decided that, from 1 January 2014, all supervisory employees will have to obtain forty continuing professional
development (CPD) points (i.e. hours) each year. In this way, training and development will become even more of a strategic tool for improving supervision.

Management development (MD)
Various MD activities are undertaken to support the performance of DNB management. The didactic design of these activities takes the Polaris strategic plan and the divisions’ policy plans into account. Activities that focus on developing management talent include:

- The one-year Leadership Development programme (VLOT), which is intended for employees seen as having the required leadership potential, prepares participants in the course of a year for possible managerial appointments.
- The Leadership and Flexibility (LeF) and Executive Trajectory (ET) programmes, which prepare selected department heads for a possible transition to more senior leadership roles. In addition to their network function, these programmes focus on developing personal and leadership qualities and give participants the opportunity to work on some of the challenges facing the division or organisation. They also provide a link to the Polaris ambitions.

Single Supervisory Mechanism
From 1 November 2014, the ECB will have final responsibility for supervising banks in the euro area (the Single Supervisory Mechanism – SSM). The ECB is looking for people throughout Europe to fill these responsible and challenging roles. As a member of the European System of Central Banks (ESCB), DNB is seeking to have suitable staff from its own organisation appointed to positions at the ECB. This was already happening in the case of monetary policy tasks and is now being extended to include European banking supervision. To this end, the following action was taken in 2013, or will be taken in 2014:

- identifying and actively approaching potentially suitable candidates;
- removing any possible obstacles;
- providing information on living and working in Frankfurt;
- providing information on recruitment and selection;
- providing training to improve candidates’ command of English, as well as preparing them to work in an international environment and to apply new supervisory methods.

Diversity
Having signed the Talent to the Top Charter, the Governing Board reiterated in early 2013 its target of having 32% of management positions filled by women by 2014. The percentage achieved in 2013 was 30%. When recruiting new staff, DNB looks for women who have gained management experience outside DNB. This resulted in the appointment of one candidate to a management position in 2013. In the case of internal appointments to management positions, the composition of a division’s management team from a perspective of male/female diversity is consistently taken on board. All the development programmes also address the issue of diversity. In order to continue promoting greater male/female diversity, the Governing Board has decided to aim for 50% participation by women in the DNB traineeship programme. This target was not achieved in 2013, partly because far fewer women than men applied for the traineeship programme. This is due to the fact that women are underrepresented in the job profiles for which DNB is seeking to recruit young graduates (i.e. background in economics or econometrics). DNB wants to create added value by capitalising on the diversity of its workforce. The focus in this respect is not only on male/female diversity, but also on other aspects such as ethnic
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origins, religious beliefs and sexual orientation. Eleven DNB mentors provided guidance to refugee students during the year as part of our sponsorship of the UAF Foundation for Refugee Students.

**Employee satisfaction survey**

DNB held its annual employee satisfaction survey in October 2013. The score for general satisfaction continued its rising line, increasing from 7.5 (out of 10) in 2011 to 7.6 in 2012 and 7.7 in 2013. The 37.6% score for inspired and committed employees was above the benchmark of 36.3%. Achieving DNB’s ambition of being able to recruit and retain highly talented people will depend on factors such as the quality of management, as well as on the organisation’s ability to offer its employees challenges and opportunities for personal development. The scores for these aspects in the survey also rose during the year. The level of satisfaction with management rose from 7.2 in 2012 to 7.4 in 2013, while satisfaction with the opportunities for development rose from 6.9 in 2012 to 7.0 in 2013. Both scores were above the 2013 benchmark scores of 7.3 and 6.6, respectively.

**Employee development and career progression**

Offering satisfactory opportunities for growth and development is a way for DNB to ensure it can retain the best people for the organisation. In cases where a perfect match is not yet in place, training courses, career counselling, job rotation and departures are used as instruments to have employees move on to positions to which they are better suited.

**Performance management**

A new version of the performance management system (PM2.0) became operational for all DNB employees in 2013. This will enable DNB to focus even more on performance. To this end, a seven-point assessment scale, which replaces the existing five-point scale, has been adopted and the rules of the system have been clarified. The revamped system will be reviewed once the performance appraisals for 2013 have been completed (in other words, after February 2014).

**Health and working conditions**

The sickness reporting frequency fell from 1.14 in 2012 to 1.05 in 2013, while the sickness absence rate remained the same at 2.88%. The sickness absence rate for large banks came out at 3.43% in 2013. Psychological complaints accounted for much of this absence and many of these cases were of a long-term nature. The Occupational Health and Safety Service will be devoting extra attention to this issue in 2014. The bank’s HR advisers will be consulted on how line management can be helped to identify psychological problems at an early stage and thus enable preventive action to be taken. The 2014 focus areas will be vitality, a healthy lifestyle and sustainable deployment of employees.

DNB is committed to continually improving its working conditions. In 2012, the globally accepted OHSAS 18001 standard was implemented and certified in the Cash Operations department, where the physical workload is relatively high. OHSAS stands for Occupational Health and Safety Assessment. The external audit will be held in February 2014.

The Cash Operations department has devised policy for promoting the sustainable deployment of employees that takes account of their physical workload. This is because the average age of employees in Cash Operations is now over 50. The policy will focus on reducing the physical workload and on encouraging task rotation and employability. The Logistics and Sorting unit has
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worked with P&O to compile a strategic staffing plan, following an analysis of current and future staffing levels. This will form the basis for action to improve the sustainable deployment of employees. Implementation of the policy on sustainable deployment will continue during 2014. The focus here is on developing resources to reduce the physical workload, on workplace studies of jobs involving heavy physical workloads as well as office work places, and on opportunities for job rotation. The aim in this respect is to achieve the maximum possible variation in employees’ work. Account is also taken of the composition of teams, with additional staff being deployed in the event of physically demanding activities.

Collective Labour Agreement

All employee salaries were raised by 0.58% on 1 July 2013. This rise was based on the basket now tracked by DNB and the AFM for collective pay rises. DNB’s pension scheme was changed with effect from 1 January 2014 in response to new tax legislation. The most important change in this respect relates to the rise in the standard retirement age from 65 to 67. In line with the changes in the pension scheme, the leave scheme for older DNB employees was discontinued from 1 February 2014. DNB is currently discussing a policy on vitality with the unions. Both parties understand the importance of good policy in ensuring employees remain fit and healthy.

5.8.3 Compliance and integrity

DNB may be expected to demonstrate the highest level of integrity and DNB’s compliance and integrity programme is designed to ensure it can live up to these expectations. The aim of this programme is to manage integrity risks and to promote ethical conduct by the organisation and its employees. The Compliance and Integrity (C&I) department provides guidance to management on setting an example and seeks to ensure employees are aware of their professional duty to act with integrity.

Continued management of principal integrity risks

Efforts were undertaken in 2013 to deal with the integrity risks prioritised in late 2012. DNB’s information security platform identified a solution that sharply reduced the number of inadvertently sent e-mails. In addition, DNB analysed the compliance and integrity risks that can arise through the use of insourced workers, while also giving consideration during discussions with management to the risks specifically facing managers. These include the risks involved in handling confidential information, problems relating to inadvertently sent e-mails and the use of insourced staff. These discussions will continue in 2014.

Continuing development of ethical culture within DNB

Various actions were taken in 2013 to embed an ethical culture within DNB. These included the organisation of twelve workshops for teams and the revision of the contents of the orientation programme for new staff. This resulted in higher attendance at the introductory workshops, fourteen of which were held in 2013. Lastly, in January 2014, DNB launched a system for measuring ethical awareness.

Promoting an active and facilitating role for management

All managers completed the revised, two-yearly management self-assessment in 2013 to show how they manage ethical conduct in practice. The results were compared with those of 2011 and discussed with management at a departmental level. These discussions were followed by various activities, ranging from workshops to risk analyses, while a special meeting was also arranged for managers
on the subject of exemplary conduct. The self-assessment will be further improved, based on the points identified by managers, and will next be held in 2015.

Mirroring other supervisors
DNB has shared its knowledge and experience with compliance and integrity with various parties, including the tax authorities, the Amsterdam municipal Integrity Bureau and the UWV Employee Insurance Agency. It also arranged an international seminar on compliance and integrity for central banks and supervisors. Representatives from twenty-one different organisations took part in the seminar.

Effective and efficient implementation of basic operational tasks; compliance with integrity rules
Employees submit reports, requests for advice and incident reports (mainly electronically) to C&I, which then uses a computerised system to handle them (see the CSR Annex to the Annual Report 2013).

Integrity incidents
An integrity incident or suspected integrity incident occurs when there is a risk that DNB’s integrity or reputation, or that of its employees, could be compromised by an infringement of internal or external laws or regulations.

Most of the incidents in 2013 related to careless handling of information (see the CSR Annex to the Annual Report 2013). All incidents were investigated. In most cases it was established that an irregularity had indeed occurred. A special or preliminary investigation is launched for incidents where an employee’s reliability is being questioned. In 2013, five such investigations were initiated into careless handling of price-sensitive information, a possible breach of confidentiality provisions, suspected incorrect claims for hours worked (two investigations) and an employee’s criminal history. In four of the cases it was established that no integrity regulations had been breached. The fifth investigation had not yet been completed at the time of writing of this Annual Report.

5.8.4 Environmental care
DNB has set ambitious environmental objectives. From 2014, for example, it is seeking to be climate neutral by purchasing green energy and offsetting its remaining CO₂ emissions through Gold Standard credits.

In 2013, DNB also started investigating the opportunities for a new lease policy based on a remuneration benchmark (market standards). In light of the results of this investigation, the Governing Board decided to align the lease policy with the organisation’s CSR policy.

The focus areas of DNB’s environmental policy are compliance with legislation and regulations, management of environmental risks and a permanent commitment to improving the organisation’s environmental performance. Progress in this respect is monitored through audits, with environmental performance being measured against the Stimular environmental barometer (see www.milieubarometer.nl). Results achieved are subject to periodic assessment. DNB operates an ISO 14001-certified environmental management system for three departments that have a significant environmental impact.

Environmental policy also plays an important role in the ICT function. Policy in this area focuses on ensuring the sustainable provision of ICT services, from procurement to disposal. Equipment written off by DNB is given a new lease of
life through the Close the Gap foundation. Other examples of recycling within DNB include Payments’ recycling of rejected money containers into pellets, while the seals used to secure transport and storage units for banknotes and coins are also recycled. More information on DNB’s environmental policy can be found in the CSR Annex to the Annual Report 2013.

5.8.5 Sustainable procurement

DNB revised its policy on sustainable procurement during the year under review. Alongside legitimacy and efficiency (see Section 5.4), CSR is now one of the pillars of this policy. This means that DNB takes account of the impact of purchased products, services and labour on society. In other words, the social, environmental and economic consequences for society in general, and for DNB, its suppliers, their employees and any subcontractors in particular.

Under the revised procurement policy, DNB will continue seeking, for example, to apply the social and the environmental criteria set by the Dutch government (NL Agency). Available social criteria will be applied wherever possible, while CSR will also become an integral part of the strategy set for each European tender. One of the objectives of DNB’s procurement policy for 2013 was 100% sustainable procurement through application, wherever possible, of the NL Agency’s environmental criteria. These criteria were applicable and applied to three of the sixteen European tenders carried out (and completed) in 2013. In addition, all the European tenders considered whether any additional sustainability aspects could be taken into account. These additional requirements were included in two tenders – the renovation of the Sarphatistraat offices and the procurement of armoured transport vehicles. In addition, the DNB code of conduct and integrity rules, which focus on such things as preventing conflicts of interest and bribery, apply both to DNB’s own staff and to insourced workers.

Banknotes made from sustainable cotton

Since 2007, DNB has required its banknote suppliers to include a proportion of sustainably produced cotton in their products. An example of this is the fair trade cotton system, which guarantees that cotton farmers receive a fair price and sets conditions for issues such as human rights (no child labour) and environmental aspects (no use of pesticides). The Fairtrade Labelling Organization carries out local inspections to verify that these conditions are being observed. Since 2012, DNB has also offered suppliers the option of using a proportion of organically farmed cotton in addition to fair trade cotton.

DNB ordered 825 million banknotes in 2013. The paper used by suppliers contained 9% fair trade cotton and 25% organically grown cotton, meaning that a total of 30% of the cotton used was sustainably produced. An additional positive development is that DNB played a leading role in the Eurosystem agreement that all national central banks will start using sustainably produced cotton in their banknotes in 2014.

By analogy with the use of fair trade cotton in the clothing industry, DNB agreed to pay a bonus for increasing the availability of fair trade cotton for banknotes. In 2013, the Solidaridad Network was once again responsible for allocating this bonus. The money went to the ProCotton project, an initiative of the Rabobank Foundation and Solidaridad aimed at encouraging small-scale farming organisations in developing countries to participate in sustainable textile chains and thus increasing the supply of all kinds of sustainable cotton. The ProCotton project’s main aim is to improve cotton farming communities’ standard of living and prosperity.
5.8.6 Social commitment

Contributions and donations
DNB assesses requests for financial and non-financial contributions and donations on the basis of its dedicated policies in these areas. The budget of EUR 1.4 million for contributions in 2013 was the same as in 2012. In 2014, however, this budget essentially be halved because of the closing of the Money Museum and the resultant discontinuation of DNB’s annual contribution. However, in accordance with the Authorisation Decision (Bulletin of Acts and Decrees 2013, 542), DNB will take over the Money Museum’s management and conservation responsibilities, as well as the collection of the Ministry of Education, Culture and Science and that of the Dutch Royal Mint. In 2013, the donations budget of EUR 250,000 was the same as in 2012. Donations and sponsorship are decided and monitored annually at a centralised level.

DNB seeks to support activities that have some relationship to its core tasks. It provides financial and other forms of support to various organisations, mainly those in which DNB has a supervisory or advisory role or which DNB helped set up, such as the Duisenberg School of Finance, the Money Museum (GeldMuseum) – until the end of 2013 – and the Money Wise Platform (Wijzer in geldzaken). Under this platform, over forty partners from the financial sector, the public sector, public information and consumer organisations as well as the academic world have joined forces to help improve consumers’ financial awareness and education. DNB is one of the four sponsors of this project. DNB employees also spent time during the year on initiatives launched by the Child and Youth Finance International organisation, which sets out to improve the economic awareness of children and young people.

DNB makes both monetary and other donations to charities active in the fields of culture, health care and civil society. Among the recipients of DNB donations in 2013 were the Alpe d’HuZes foundation for cancer research and the SIRE public service advertising organisation. In addition, one DNB employee was also released from his DNB duties to work three days a week for Alpe d’HuZes (until 1 September 2013) and Inspire2Live. The literacy foundation Stichting Lezen & Schrijven was given the opportunity to use DNB’s reception area, while small donations were also made to Child’s Destiny of Hope, the International Foundation for Alzheimer’s Research and the Droomboom foundation for autistic children through members of staff who sit on the boards of these foundations.

Under the ‘Building Together’ (Samen Bouwen) banner, DNB employees can take part in organised volunteer work projects. Some 125 DNB employees took part in a total of thirteen voluntary work projects in 2013. This work can be broken down into three categories:

- activities involving people in a care centre, such as sea fishing, a sports day for people with a mild disability at the Cordaan Institute in Amsterdam, and the annual summer party for people with a mental disability at the ’s Heeren Loo care centre;
- activity projects, where DNB employees do odd jobs such as gardening or painting;
- knowledge transfer projects, where DNB employees work with the JINC organisation to provide job application training, short internships and coaching programmes to give young people from underprivileged backgrounds a better start in the labour market. A campaign in November 2013 resulted in almost eighty volunteers being recruited for JINC projects in 2014.
Report of the Supervisory Board
6 Report of the Supervisory Board

6.1 Introduction

Calm has returned to the financial markets, partly thanks to the announcement by the European Central Bank (ECB) of its Outright Monetary Transactions (OMT) programme in 2012 and the decision by European government leaders to create the Single Supervisory Mechanism (SSM). The economic climate improved slightly, both in the Netherlands and internationally. The risks, however, have not yet receded. The nationalisation of SNS Reaal on 1 February 2013 was a far-reaching intervention, and included the first-ever use of the Intervention Act (Interventiewet). De Nederlandsche Bank (DNB), together with the European national supervisors and the ECB, is getting ready for the transition to the SSM at the end of 2014 and, by way of preparation, has initiated the Comprehensive Assessment (CA) of significant banks. These events were a recurring topic of discussion at the meetings of the Supervisory Board in the presence of the Governing Board, partly in light of DNB’s position as central bank within the European System of Central Banks (ESCB) and as prudential supervisor. These external developments, which clearly also have major internal consequences, are reviewed in greater detail elsewhere in this annual report.

In March 2013, with a view to the risks to DNB’s balance sheet, the Dutch State issued a guarantee for DNB’s crisis-related assets. The guarantee agreement was entered into for a five-year period, but can be ended earlier or extended, depending on how the risks develop. At the time of adoption of the financial statements, the above-mentioned financial risks had not led to actual losses or to a call on this guarantee. The net profit for 2013 came to EUR 1,178 million, and the profit distribution to the Dutch State amounted to EUR 1,119 million. Partly because of the uncertainties surrounding the level of DNB’s profit, no interim dividend has been paid out since the 2011 financial year. On 8 March 2013, the Minister of Finance reported to the Dutch Senate that the payment of an interim dividend was not to be expected in the coming years.

DNB’s new governance model, which arose from the Act strengthening governance of financial supervisors DNB and AFM (Wet versterking governance DNB en AFM) and entered into force on 16 February 2012, was further elaborated in 2013. In conformity with its statutory mandate, the Supervisory Board’s role previously focused mainly on supervising management and operations at DNB. Since February 2012, however, the Board has also supervised the Governing Board’s policy in relation to the implementation of DNB’s national tasks as set out in Section 4 of the Bank Act 1998 (Bankwet 1998). These concern the implementation of DNB’s general policy and the safeguarding of the quality and effectiveness of that policy. The national tasks involve the policy aspects, including associated safeguards, of the prudential supervision conducted by
DNB, the payment systems task, the statistics task and the performance of the tasks mentioned in Section 4 on the islands of Bonaire, St Eustatius and Saba. This expansion of the supervisory role not only places demands on the Board’s composition and profile, but also on the way it operates. The Supervision Committee, which was set up in 2012, reports on the policy aspects of the prudential supervision conducted by DNB; the Audit Committee reports on the policy aspects of the other tasks under Section 4. In 2013, the Supervisory Board regularly discussed the implementation of the governance model with the Governing Board. Various aspects of the governance model were reviewed, both in the plenary meetings as well as in a separate meeting.

6.2 Composition, appointments

There were no changes to the composition of the Governing Board in 2013. As no appointments or reappointments occurred in the year under review, the Board’s male/female mix remained unchanged. The composition of the Supervisory Board also remained the same, and likewise its male/female mix. In the event of appointments and reappointments to the Governing Board and Supervisory Board, the Supervisory Board will naturally focus on the adopted profiles, which include a balanced male/female mix of the Board.

In conformity with Section 13(1) of the Bank Act 1998, the Supervisory Board numbers a minimum of seven and a maximum of ten members. At the time of adoption of the 2013 financial statements, the Supervisory Board consisted of eight members, who sat on the Board throughout the year: Alexander Rinnooy Kan (Chairman); Annemiek Fentener van Vlissingen (Vice-Chairman); Bert van Delden (Secretary); Kees Goudswaard; Jaap van Manen; Feike Sijbesma; Hélène Vletter-van Dort; and Wim Kuijken (government-appointed member).

The participation of Supervisory Board members in the Bank Council underwent no changes in 2013. Wim Kuijken sits on the Bank Council in the capacity of government-appointed Supervisory Board member. Bert van Delden, who has been designated by the Supervisory Board as member of the Bank Council, continued his membership in 2013.

The full composition of the Supervisory Board, its committees, the Governing Board and the Bank Council at the time of adoption of the 2013 financial statements is provided on page 5 of this annual report. The profiles of the Supervisory Board and Governing Board are posted on DNB’s website.

6.3 Activities

During the year under review, the Supervisory Board held eight plenary meetings in the presence of the Governing Board and one meeting outside the Governing Board’s presence. The average attendance rate of the Supervisory Board members at the nine meetings was close on 90%. None of the members was regularly absent. In addition, there was also frequent contact between the Chairman and the President on issues concerning the Supervisory Board’s work. The activities of the Board’s committees are briefly described below.

As part of the Supervisory Board’s supervision of the management and general course of business within DNB, the financial results for 2013 were discussed by the Audit Committee and in the plenary Supervisory Board meetings. These discussions were based on the periodic integrated financial report
(incorporating the former financial report and the quarterly reports of monetary operations and investments), the management letters from the external auditor and the internal audit department (IAD) and the IAD quarterly reports.

One recurring issue was the development of the balance sheet financial risks as a result of the debt crisis. The guarantee issued by the Dutch State testifies to these risks. The Supervisory Board established that the net profit fell by EUR 901 million in 2013 (from EUR 2,079 million in 2012 to EUR 1,178 million). This reflects the improvement of the risk profile, though the Board emphasises that the risks have, on the whole, remained at a high level. No gold sales took place in 2013.

The Supervisory Board held detailed discussions with the Governing Board about the 2013 financial statements and these meetings were attended by the external auditor. The opinion of the external auditor and the IAD’s analyses were taken into account in these discussions. Pursuant to Article 19(6) of the Articles of Association, the Board subsequently adopted the financial statements and offered them for approval to the General Meeting of Shareholders. On 12 March 2014, the latter adopted the financial statements, discharged the Governing Board of responsibility in respect of their management and the Supervisory Board in respect of their supervision.

The Supervisory Board discussed and approved the budget for 2014 on 22 November 2013. This concerned the first budget, where the supervisory costs were budgeted on the basis of a long-term cost framework. The Supervisory Board established that the most important internal business and operational control instruments, such as the planning and control cycle and the risk management and control system, operated effectively. No specific points for attention emerged in this context.

With regard to the internal operations, the Supervisory Board notes that in the year under review the Governing Board and management devoted attention to the processes of change taking place within DNB’s supervision. These changes create the conditions for more intensive and decisive supervision and this long-term process of change will remain a primary focus area for the Supervisory Board in the coming period. In addition, the Board is involved in the SSM from several perspectives. Given the major changes involved, the SSM represents one of the most fundamental changes for DNB. Not just in terms of the design of the supervisory processes, but also for the supervision-related governance of DNB. Furthermore, the arrival of the SSM will have far-reaching consequences for the statistics function and the internal operations of DNB. The Supervisory Board obtains information on these subjects via the Supervision Committee and the Audit Committee and, naturally, in its plenary meetings. The Supervisory Board notes that the Governing Board is taking up these challenges in an adequate manner.

In connection with the expansion of the Supervisory Board’s tasks under DNB’s new governance model, and more specifically its supervision over DNB’s policy for conducting its prudential supervisory task, the Supervisory Board — together with the Minister of Finance — commissioned an evaluation in March 2013 of whether DNB and the Ministry, acting both individually and jointly, responded in a timely and adequate manner to information, signals and developments concerning the financial position of SNS Reaal. This jointly-commissioned evaluation was carried out by the Evaluation Committee on the Nationalisation of SNS Reaal (ENS), consisting of Rein Jan Hoekstra and Jean Frijns.

The Supervisory Board was intensively involved in DNB’s activities for
the ENS. The Supervisory Board welcomes and appreciates the ENS report, which was published on 23 January 2014, and has taken the recommendations to heart. The nationalisation of SNS Reaal was a far-reaching measure, which had to be taken as an ultimate remedy, when no other alternatives proved feasible. The thorough study that ENS carried out into the manner in which the problems at SNS Reaal arose and were addressed is valuable. DNB’s principal objective was to safeguard financial stability in the Netherlands. This should not come into jeopardy, and was in fact never in jeopardy. Obviously, prior to the nationalisation of SNS Reaal, the Board devoted extensive attention to this case, both in the Supervision Committee and in plenary meetings.

Regarding the general conduct of business within DNB, the Supervisory Board looked at the consequences of the Public and Semi-Public Sector Executives Remuneration (Standards) Act (Wet normering bezoldiging topfunctionarissen publieke en semipublieke sector – WNT) for the remuneration policy for the Governing Board. The Supervisory Board expressed its concern to the shareholder about the level of the future remuneration in relation to the required quality of employees and the independence of DNB.

The Supervisory Board also devoted attention to the policy on private portfolio investment transactions of its members, discussed the adjustment of DNB’s internal private portfolio investment guidelines and adopted the adjustment of the pension scheme for the Governing Board with effect from 1 January 2014 following the increase in the retirement age to 67. The consequences of the Management and Supervision Act (Wet bestuur en toezicht) were also touched on as part of the annual discussion of external positions held by the Governing Board and Supervisory Board members.

Other topics addressed by the Supervisory Board included DNB’s activities in the framework of the migration to a Single European Payment Area (SEPA), the Dutch pension system and granting of credit in the Netherlands. The discussion of the periodic update on core task-related issues by the Board covered a wide range of subjects. At each meeting, the President informed the Supervisory Board of relevant matters concerning the Eurosystem, among other things.

In 2013, an important part of the Supervisory Board’s permanent learning programme was dedicated to the expansion of its tasks under the new governance model. In the spring, the Supervisory Board members attended a half-day session that was devoted to DNB’s payment systems and statistics tasks, and the Audit Committee extensively discussed DNB’s ICT policy, focusing in particular on information security and business continuity. In the autumn, the Supervisory Board reviewed its special role as the internal supervisor of DNB in its capacity as financial supervisor and its interaction with the Governing Board in this connection. The Supervisory Board also discussed these subjects in a meeting with the Supervisory Board of the Netherlands Authority for the Financial Markets which, in principle, will be held once every year. As part of the learning programme, various in-depth presentations were given in the meetings of the Supervisory Board and its committees on a variety of subjects, including the macroprudential instruments at DNB’s disposal for addressing systemic risks and its policy in this respect, DNB’s scientific research and DNB’s supervision of conduct and culture. As no appointments to the Supervisory Board were made in 2013, no orientation programme was organised in the year under review.

In conformity with Section 24 of the Works Councils Act (Wet op de ondernemingsraden), members of the Supervisory Board twice attended
consultation meetings between the management and the Employees Council. In 2013, one meeting also took place between the plenary Supervisory Board and the Employees Council in the presence of the Governing Board. In addition, members of the Supervisory Board periodically conduct interviews with all individual Divisional Directors and the Head of IAD without the presence of the Governing Board members. The Supervisory Board believes that these consultation meetings are particularly valuable as a means to stay in touch with the different parts of the organisation.

In 2013, the Supervisory Board again assessed its own performance, based on the completion of a questionnaire and the Chairman’s interviews with the individual members. The outcomes were discussed at a plenary meeting outside the presence of the Governing Board. At this meeting, the Supervisory Board also reviewed the performance of the Governing Board. As in the previous year, various adjustments were initiated in 2013 in order to further improve the efficiency of the information flows for the Supervisory Board.

6.4 Audit Committee

Throughout the year under review, the Audit Committee consisted of Jaap van Manen (Chairman), Wim Kuijken and Kees Goudswaard. There are no vacancies. The Audit Committee met four times during the year and all members attended every meeting. The meetings took place in the presence of the responsible member of the Governing Board, Frank Elderson, as well as the external auditor, the Director of Finance & ICT, the Director of the Financial Markets Division, the Head of IAD, the deputy company secretary and a number of internal officials from the relevant policy areas. The Directors of the Payments Division and the Statistics and Information Division join the Audit Committee meetings whenever subjects pertaining to their divisions are on the agenda.

The Audit Committee discussed the financial statements at length, including the relevant reports of the IAD and the findings of the external auditor. Extensive attention was devoted to the balance sheet risk exposure in connection with the European debt crisis. The committee advised the Supervisory Board to adopt the financial statements as well as to approve the Independent Public Body Report for 2013. Based on the discussion of the draft budget for 2014 and the resulting definitive budget, the Audit Committee concluded that the budget is clear and responsible. It therefore advised the Board to approve the 2014 DNB Budget including the 2014 Independent Public Body Budget. In 2013, the Audit Committee, as customary, paid considerable attention to the report and the management letters of the external auditor and the IAD, the IAD quarterly reports, the integrated financial report and the quarterly reports from the Compliance and Integrity Department. It was established that the Governing Board gave sufficient attention to the findings and recommendations set out in the management letters. The Audit Committee also discussed the charters of DNB’s Investment Committee and DNB’s Risk Management Committee, the strategic asset allocation and the internal private portfolio investment guidelines as well as the DNB risk management framework and policy. In connection with the Supervisory Board’s supervision of DNB’s policy on its national payment systems task, the Audit Committee devoted attention to the ICT problems at banks resulting from cyber attacks, among other topics.
6.5 Remuneration and Appointments Committee

Throughout the year under review, the Remuneration and Appointments Committee consisted of Annemiek Fentener van Vlissingen (Chairman), Alexander Rinnooy Kan and Feike Sijbesma. Wim Kuijken joined the committee with effect from 1 January 2014. There are no vacancies. The Remuneration and Appointments Committee met eight times in 2013. On average, these meetings were attended by close on 90% of the Supervisory Board members. None of the members were regularly absent. The meetings took place in the presence of the President, the responsible member of the Governing Board, Frank Elderson, and the company secretary or her deputy.

In the meetings of the Remuneration and Appointments Committee, a lot of attention was devoted to the consequences of the entry into force of the Public and Semi-Public Sector Executives Remuneration (Standards) Act, as well as to vacancies on the Supervisory Board. Further to the discussion of this issue in the Supervisory Board, the Remuneration and Appointments Committee spoke with the President about his performance and that of the other Governing Board members.

6.6 Supervision Committee

Throughout the year under review, the Supervision Committee consisted of Hélène Vletter-van Dort (Chairman), Bert van Delden and Kees Goudswaard, with Alexander Rinnooy Kan acting as an observer member. There are no vacancies. In principle, the Supervision Committee, like the Audit Committee, meets four times a year. As the Chairman of the Supervision Committee acted as the delegated principal of the Evaluation Committee on the Nationalisation of SNS Reaal, two additional Supervision Committee meetings were called in 2013. The committee therefore held six meetings in 2013, each time with all members in attendance. The meetings took place in the presence of the responsible members of the Governing Board, Jan Sijbrand and Joanne Kellermann, the company secretary and the secretary of the Prudential Supervision Council for Financial Institutions, as well as a number of internal officers of the supervision divisions.

In 2013, the meetings again focused on a combination of practical cases, current policy issues, a closer introduction to the supervision divisions and a more in-depth explanation of various supervisory topics. Examples are the quality framework of DNB’s supervision, a discussion of the DNB Supervisory Strategy and the remuneration policy. Clearly, the Supervision Committee also looked in detail at the imminent arrival of the SSM and its consequences for DNB’s prudential banking supervision. As part of the Supervisory Board’s supervision of DNB’s policy in respect of its prudential supervision, the committee devoted attention to a number of issues, including the Rabobank’s involvement in the manipulation of the Libor and Euribor interest rates and DNB’s supervision on the compliance with the Regulation on Sound Remuneration Policies in the light of retention bonuses. The Supervision Committee, like the Audit Committee, advised the Supervisory Board to approve the Independent Public Body Budget for 2014. The Supervision Committee was set up in March 2012 and assessed its own performance one year after its inception.

6.7 Declaration of Independence

The Regulation on Incompatible Positions and the Regulation on Conflicts of Interest apply to Supervisory Board members without restriction. Supervisory Board members are not and have never been employed by DNB, nor do they have any relationship with DNB from which they could obtain personal gain.
Supervisory Board members receive a fixed annual fee that is not related to the DNB’s results in any given year. All Supervisory Board members are independent within the meaning of the Dutch Corporate Governance Code.

6.8 Concluding words

Clearly, 2013 was another highly eventful year, in which DNB was unrelentingly confronted with many challenging developments. Although the debt crisis abated, DNB must, in its capacity as a central bank within the ESCB, remain as vigilant as ever. As a prudential supervisor, DNB successfully expanded its supervisory capacity and the entire organisation is preparing for the fundamental changes resulting from the arrival of the SSM. In the year under review, it once again became clear that weaknesses existed in a number of the supervised institutions. We note that the Governing Board and employees tackled the various problems with outstanding knowledge and expertise, in combination with unflagging energy and admirable resilience. For this reason, the Supervisory Board would like to express its appreciation to the Governing Board and employees for their commitment in 2013 and looks forward to its continuing cooperation with the Governing Board with great confidence.

Amsterdam, 12 March 2014

The Supervisory Board of
De Nederlandsche Bank NV

Alexander Rinnooy Kan, Chairman
Bert van Delden, Secretary
Financial statements
## Balance sheet as at year-end 2013 (before appropriation of profit)

### Millions

<table>
<thead>
<tr>
<th>Assets</th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Gold and gold receivables</td>
<td>17,155</td>
<td>24,834</td>
</tr>
<tr>
<td>2 Claims on non-euro area residents denominated in foreign currency</td>
<td>16,198</td>
<td>16,414</td>
</tr>
<tr>
<td>2.1 Receivables from the International Monetary Fund (IMF)</td>
<td>8,216</td>
<td>8,867</td>
</tr>
<tr>
<td>2.2 Balances with banks and security investments, external loans and other external assets</td>
<td>7,982</td>
<td>7,547</td>
</tr>
<tr>
<td>3 Claims on euro area residents denominated in foreign currency</td>
<td>0</td>
<td>152</td>
</tr>
<tr>
<td>4 Claims on non-euro area residents denominated in euro</td>
<td>243</td>
<td>185</td>
</tr>
<tr>
<td>5 Lending to euro area credit institutions related to monetary policy operations, denominated in euro</td>
<td>8,814</td>
<td>24,511</td>
</tr>
<tr>
<td>5.1 Main refinancing operations</td>
<td>0</td>
<td>32</td>
</tr>
<tr>
<td>5.2 Longer-term refinancing operations</td>
<td>8,814</td>
<td>24,479</td>
</tr>
<tr>
<td>5.3 Fine-tuning reverse operations</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5.4 Structural reverse operations</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5.5 Marginal lending facility</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5.6 Credits related to margin calls</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6 Other claims on euro area credit institutions denominated in euro</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>7 Securities of euro area residents denominated in euro</td>
<td>30,176</td>
<td>26,563</td>
</tr>
<tr>
<td>7.1 Securities held for monetary policy purposes</td>
<td>13,041</td>
<td>14,778</td>
</tr>
<tr>
<td>7.2 Other securities</td>
<td>17,135</td>
<td>11,785</td>
</tr>
<tr>
<td>8 Claims within the Eurosystem</td>
<td>82,791</td>
<td>153,195</td>
</tr>
<tr>
<td>8.1 Participating interests in the ECB</td>
<td>469</td>
<td>469</td>
</tr>
<tr>
<td>8.2 Claims equivalent to the transfer of foreign reserves to the ECB</td>
<td>2,299</td>
<td>2,297</td>
</tr>
<tr>
<td>8.3 Claims related to the issuance of ECB debt certificates</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>8.4 Other claims within the Eurosystem (net)</td>
<td>45,709</td>
<td>119,860</td>
</tr>
<tr>
<td>8.5 Net claims related to the allocation of euro banknotes within the Eurosystem</td>
<td>34,314</td>
<td>30,569</td>
</tr>
<tr>
<td>9 Other assets</td>
<td>3,051</td>
<td>8,538</td>
</tr>
<tr>
<td>9.1 Euro area coins</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>9.2 Tangible and intangible fixed assets</td>
<td>246</td>
<td>250</td>
</tr>
<tr>
<td>9.3 Other financial assets</td>
<td>1,856</td>
<td>6,968</td>
</tr>
<tr>
<td>9.4 Off-balance sheet instruments revaluation differences</td>
<td>292</td>
<td>356</td>
</tr>
<tr>
<td>9.5 Accruals and prepaid expenses</td>
<td>646</td>
<td>943</td>
</tr>
<tr>
<td>9.6 Sundry</td>
<td>3</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>158,528</strong></td>
<td><strong>254,392</strong></td>
</tr>
</tbody>
</table>

Amsterdam, 12 March 2014
The Governing Board of De Nederlandsche Bank NV

K.H.W. (Klaas) Knot, President
A.J. (Joanne) Kellermann

DNB / Annual Report 2013
### Financial statements

#### Liabilities

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Banknotes in circulation</td>
<td>50,161</td>
<td>47,856</td>
</tr>
<tr>
<td>2 Liabilities to euro area credit institutions related to monetary policy operations, denominated in euro</td>
<td>73,938</td>
<td>158,038</td>
</tr>
<tr>
<td>2.1 Current accounts (covering the minimum reserve system)</td>
<td>37,866</td>
<td>87,593</td>
</tr>
<tr>
<td>2.2 Deposit facility</td>
<td>9,157</td>
<td>14,370</td>
</tr>
<tr>
<td>2.3 Fixed-term deposits</td>
<td>26,915</td>
<td>56,075</td>
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<tr>
<td>2.4 Fine-tuning reverse operations</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2.5 Deposits related to margin calls</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>3 Liabilities to other euro area residents denominated in euro</td>
<td>965</td>
<td>134</td>
</tr>
<tr>
<td>3.1 General government</td>
<td>47</td>
<td>7</td>
</tr>
<tr>
<td>3.2 Other liabilities</td>
<td>918</td>
<td>127</td>
</tr>
<tr>
<td>4 Liabilities to non-euro area residents denominated in euro</td>
<td>1,774</td>
<td>5,873</td>
</tr>
<tr>
<td>5 Liabilities to euro area residents denominated in foreign currency</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6 Liabilities to non-euro area residents denominated in foreign currency</td>
<td>315</td>
<td>0</td>
</tr>
<tr>
<td>7 Counterpart of special drawing rights allocated by the IMF</td>
<td>5,409</td>
<td>5,638</td>
</tr>
<tr>
<td>8 Liabilities within the Eurosystem</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>8.1 Liabilities related to the issuance of ECB debt certificates</td>
<td>0</td>
<td>0</td>
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<tr>
<td>8.2 Other liabilities within the Eurosystem (net)</td>
<td>0</td>
<td>0</td>
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<tr>
<td>9 Other liabilities</td>
<td>116</td>
<td>2,751</td>
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<tr>
<td>9.1 Accruals and income collected in advance</td>
<td>75</td>
<td>74</td>
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<tr>
<td>9.2 Sundry</td>
<td>41</td>
<td>2,677</td>
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<tr>
<td>10 Provisions</td>
<td>15</td>
<td>32</td>
</tr>
<tr>
<td>11 Revaluation accounts</td>
<td>16,846</td>
<td>24,284</td>
</tr>
<tr>
<td>12 Capital and reserves</td>
<td>7,811</td>
<td>7,707</td>
</tr>
<tr>
<td>12.1 Issued capital</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>12.2 General reserve</td>
<td>7,287</td>
<td>7,192</td>
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<tr>
<td>12.3 Statutory reserve</td>
<td>24</td>
<td>15</td>
</tr>
<tr>
<td>13 Profit for the year</td>
<td>1,178</td>
<td>2,079</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>158,528</strong></td>
<td><strong>254,392</strong></td>
</tr>
</tbody>
</table>
## Profit and Loss Account for the year 2013

**Millions**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1 Interest income</strong></td>
<td>1,738</td>
<td>2,933</td>
</tr>
<tr>
<td><strong>2 Interest expense</strong></td>
<td>-100</td>
<td>-377</td>
</tr>
<tr>
<td><strong>Net interest income</strong></td>
<td>1,638</td>
<td>2,556</td>
</tr>
<tr>
<td><strong>3 Realised gains/losses arising from financial operations</strong></td>
<td>120</td>
<td>337</td>
</tr>
<tr>
<td><strong>4 Write-downs to lower market value</strong></td>
<td>-34</td>
<td>-42</td>
</tr>
<tr>
<td><strong>Net result from financial operations and write-downs</strong></td>
<td>86</td>
<td>295</td>
</tr>
<tr>
<td><strong>5 Fees and commissions income</strong></td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td><strong>6 Fees and commissions expense</strong></td>
<td>-10</td>
<td>-8</td>
</tr>
<tr>
<td><strong>Net result from fees and commissions</strong></td>
<td>-1</td>
<td>2</td>
</tr>
<tr>
<td><strong>7 Income from equity shares and participating interests</strong></td>
<td>126</td>
<td>61</td>
</tr>
<tr>
<td><strong>8 Net result of monetary income pooling</strong></td>
<td>-467</td>
<td>-909</td>
</tr>
<tr>
<td><strong>9 Other income</strong></td>
<td>145</td>
<td>385</td>
</tr>
<tr>
<td><strong>Total net income</strong></td>
<td>1,527</td>
<td>2,390</td>
</tr>
<tr>
<td><strong>10 Staff costs</strong></td>
<td>-203</td>
<td>-194</td>
</tr>
<tr>
<td><strong>11 Other administrative expenses</strong></td>
<td>-84</td>
<td>-79</td>
</tr>
<tr>
<td><strong>12 Depreciation of (intangible fixed assets</strong></td>
<td>-32</td>
<td>-27</td>
</tr>
<tr>
<td><strong>13 Costs of production of banknotes</strong></td>
<td>-37</td>
<td>-14</td>
</tr>
<tr>
<td><strong>14 Other expenses</strong></td>
<td>-1</td>
<td>-1</td>
</tr>
<tr>
<td><strong>15 Capitalised costs of software</strong></td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td><strong>Profit for the year</strong></td>
<td>1,178</td>
<td>2,079</td>
</tr>
</tbody>
</table>

Amsterdam, 12 March 2014
The Governing Board of De Nederlandsche Bank NV

K.H.W. (Klaas) Knot, *President*
A.J. (Joanne) Kellermann
J. (Jan) Sijbrand
F. (Frank) Elderson
J. (Job) Swank

Amsterdam, 12 March 2014
Adopted by the Supervisory Board of De Nederlandsche Bank NV

A.H.G. Rinnooy Kan, *Chairman*  
K.P. Goudswaard
F. Sijbesma

A.M. Fentener van Vlissingen, *Vice-chairman*  
W.J. Kuijken
H.M. Vletter-van Dort

A.H. van Delden, *Secretary*  
J.A. van Manen
Notes to the Balance Sheet as at 31 December 2013 and the Profit and Loss Account for the year 2013

1 Valuation and accounting policies

The Financial Statements are compiled according to the accounting models and policies applying to the European Central Bank (ECB) and the European System of Central Banks (ESCB) and the harmonised notes to the balance sheet and the Profit and Loss Account (hereafter referred to as the ‘ESCB accounting policies’). Otherwise, the Financial Statements observe the provisions of Title 9, Volume 2 of the Dutch Civil Code, in line with the provisions of Section 17 of the Bank Act 1998.

The ESCB accounting policies are broadly in line with financial reporting principles generally accepted in the Netherlands. In deviation from Title 9, Volume 2 of the Dutch Civil Code:

a. Unrealised positive results from revaluable assets and liabilities are not reported in the Profit and Loss Account but included in a revaluation account on the balance sheet;

b. No cash flow statement is included.

Comparison with preceding year

The accounting policies have not changed compared with the preceding year. The presentation of the figures has changed in two respects. As of this year, the balance sheet is presented before appropriation of profit. In the balance sheet, the item ‘Off-balance sheet instruments revaluation differences’ has been added under ‘Other assets’. The corresponding figures on the year 2012 have been adjusted to reflect this change. This presentation of the balance sheet is in line with the ESCB accounting principles.

General observations

Gold and gold receivables, marketable securities and on- and off-balance sheet claims and liabilities denominated in foreign currency are valued at market prices as at the last business day of the financial year. Readily marketable equities reported on the balance sheet under ‘Securities of euro area residents denominated in euro’ are valued at amortised cost, taking any unusual depreciation or unusual market value into account. The remaining assets and liabilities are presented at acquisition price or at face value, taking any unusual depreciation into account. Transactions in financial assets and liabilities are reflected in the accounts as at the settlement date, with the exception of foreign exchange transactions, financial instruments denominated in foreign currency and the related accruals, which are reported as at the cut-off date (in accordance with the economic approach).

Revaluation differences arising from price differences in respect of securities are determined on a security-by-security basis. Revaluation differences arising from exchange rate differences are determined on a portfolio-by-portfolio and currency-by-currency basis. Unrealised revaluation gains are added to the ‘Revaluation accounts’. Unrealised revaluation losses are charged to the ‘Revaluation accounts’ if the balance of these accounts was positive. Any shortfall is taken to the Profit and Loss Account as at the end of the financial year. Losses arising from exchange rate revaluation in any one currency are not netted against gains arising from exchange rate differences in any other currency or against price gains. Losses arising from price revaluation of a security are not netted against gains arising from a price revaluation of another security or gains arising from exchange rate differences. For gold and gold receivables, no distinction is made between price revaluation and exchange rate revaluation.
Conversion of foreign currencies

Assets and liabilities denominated in foreign currency are converted into euro at the ECB market exchange rate for the last business day of the financial year. Income and expenses are converted at the market exchange rate prevailing at the time of the transaction. The exchange rate revaluation of foreign currency assets and liabilities, including foreign currency off-balance sheet claims and liabilities, is performed on a per-portfolio and per-currency basis.

Gold and gold receivables

Gold and gold receivables are valued at market price. This market price in euro is derived from the gold valuation in USD as at the last working day of the financial year as stated by the ECB.

 Marketable securities and private loans

Marketable securities (including equities) and private loans are valued at market price as at the last business day of the financial year, except for marketable securities classified as held to maturity. The latter are valued at amortised cost, taking any impairment into account, and represented on the balance sheet under ‘Securities of euro area residents denominated in euro’. Price revaluation is performed on a security-by-security basis; unlisted securities are valued at cost or at lower market price. Investments in securities and private loans are included in the following balance sheet items: ‘Claims on non-euro area residents denominated in foreign currency’, ‘Claims on euro area residents denominated in foreign currency’, ‘Claims on non-euro area residents denominated in euro’, ‘Other claims on euro area credit institutions denominated in euro’, ‘Securities of euro area residents denominated in euro’ (sub-item ‘Other securities’) and ‘Other assets’ (sub-item ‘Other financial assets’).

Repurchase and reverse repurchase agreements

Repurchase agreements consist of a spot sale of securities hedged by a forward purchase of the same securities. The receipts from the spot sale are shown in the balance sheet as a deposit. In the light of the forward purchase, the securities continue to be shown under assets; hence, the amount involved in the forward purchase is shown on the balance sheet under liabilities.

Reverse repurchase agreements are reported as granted loans. The collateral received is not shown on the balance sheet and does not, therefore, affect the balance sheet position of the portfolios concerned. Repurchase and/or reverse repurchase agreements are included in the following balance sheet items: ‘Balances with banks and security investments, external loans and other external assets’, ‘Claims on non-euro area residents denominated in euro’, ‘Other claims on euro area credit institutions denominated in euro’, ‘Other assets’, (‘Other financial assets’), ‘Liabilities to other euro area residents denominated in euro’ (Other liabilities), ‘Liabilities to non-euro area residents denominated in euro’, ‘Liabilities to non-euro area residents denominated in foreign currency’ and ‘Other Liabilities’.

Other financial instruments

The item ‘Other financial instruments’ includes currency forward, currency swap and interest rate swap contracts. Currency forward and currency swap contracts are valued at forward prices, taking account of currency revaluations. Such revaluation differences observe the revaluation rules set out under ‘General observations’ above. The results of the revaluation of these forwards and swaps, and any unamortised forward returns are reported on the balance sheet under ‘Accruals and prepaid expenses’. For further specification see the item
concerned in the Notes to the balance sheet below. Interest rate swap contracts engender mutual cash flows. Results are allocated to the associated periods. Price revaluations on interest rate swaps follow the rules stated under General observations above.

**Intra-ESCB and intra-Eurosystem claims and liabilities**

- Other claims and liabilities within the Eurosystem

Intra-ESCB positions are the result of cross-border payments within the EU settled in euro by the central banks. Most are settled within TARGET2 (Trans-European Automated Real-time Gross settlement Express Transfer system) and give rise to bilateral balances in the TARGET2 accounts held by the EU central banks. On a daily basis, such bilateral balances are netted and assigned to the ECB, leaving every NCB with a single net bilateral balance vis-à-vis the ECB. DNB’s position vis-à-vis the ECB and arising from TARGET2 transactions is presented, together with other euro-denominated positions within the ESCB (such as interim profit distributions to the NCBs and monetary income results), as a single asset or liability item under ‘Other claims within the Eurosystem (net)’ or ‘Other liabilities within the Eurosystem (net)’. Positions held within the ESCB vis-à-vis NCBs outside the euro area and arising from TARGET2 transactions are accounted for under ‘Claims on non-euro area residents denominated in euro’ or ‘Liabilities to non-euro area residents denominated in euro’.

- Net claims related to the allocation of euro banknotes within the Eurosystem

Intra-ESCB balances arising from the allocation of euro banknotes within the Eurosystem are included as a net single asset or liability under ‘Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem’ (see below under ‘Banknotes in circulation’).

**Participating interests**

Participating interests are valued at purchase price. Income from participating interests is included in the Profit and Loss Account under ‘Income from ordinary shares and other equity’.

**Tangible and intangible fixed assets**

(In)tangible fixed assets are valued at purchase price less depreciation and/or impairment. For investments in intangible assets, in addition to the primary purchase price and the costs of external advisers relating to these assets, the in-house hours spent on these assets are also capitalised. For intangible fixed assets, a statutory reserve has been created. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset. The estimated useful life of buildings and renovations is 25 years, that of equipment, plant and furniture 10 years and that of computer hardware, software, motor vehicles and intangible assets 4 years. Land is not depreciated. Retired tangible fixed assets are valued at the lower of book value and expected realisable value.

**Banknotes in circulation**

The ECB and the seventeen participating NCBs, together forming the Eurosystem, issue banknotes. The total value of the banknote circulation is apportioned to the individual Eurosystem NCBs on the last business day of every month, according to the banknote allocation key.

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1 Decision of the European Central Bank of 15 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29), OJ L 35 of 9.2.2011, p. 26. As of 1 January 2014, as a result of the accession of Latvia to the euro, the number of NCBs participating in the Eurosystem has grown to eighteen.

2 The banknote allocation key is based on the ECB’s share in the total euro banknote issue and the shares of the Eurosystem national central banks in the remainder of such issue in proportion to their contributions to the ECB’s subscribed capital (Capital Share Mechanism or CSM).
The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, while the remaining 92% is allocated to the NCBs in proportion to their weightings in the capital key of the Eurosystem. The share of banknotes in circulation allocated to each NCB is accounted for on the liabilities side of the balance sheet under ‘Banknotes in circulation’.

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes actually circulated by that NCB gives rise to further intra-Eurosystem positions. These interest-bearing claims or liabilities are disclosed under sub-item ‘Claims within the Eurosystem – Net claims related to the allocation of euro banknotes within the Eurosystem’.

For the five years following the year of the cash changeover, the intra-Eurosystem positions arising from the allocation of euro banknotes are adjusted in order to prevent significant changes in NCBs’ relative income positions as compared to previous years. The adjustments are effected by taking into account the differences between the average value of banknotes put into circulation by each NCB in the reference period and the average value of banknotes that would have been allocated to them during that period under the Eurosystem capital allocation key. The adjustments are reduced in annual stages until the first day of the sixth year after the cash changeover year. From then on, the income on banknotes is allocated fully to the NCBs in proportion to their paid-up shares in the ECB’s capital. For the Central Bank of Cyprus and the Central Bank of Malta, this period ended on 31 December 2013, for the Národná banka Slovenska it will end on 31 December 2014 and for the Eesti Pank on 31 December 2016. The interest income and expense on these positions are settled through the accounts of the ECB and are disclosed under ‘Net interest income’.

Distribution of profit by the ECB

The Governing Council of the ECB has decided that the seigniorage income of the ECB, arising from the 8% share of euro banknotes in circulation allocated to the ECB, as well as the proceeds from securities ensuing from the Securities Markets Programme (SMP), will accrue in full to the NCBs in the year in which this income is realised. Unless the ECB Governing Council decides otherwise, the ECB will, in January of the following year, distribute this amount among the NCBs in the form of an interim profit distribution. Before year’s end, the Governing Council may decide to retain the proceeds from the Securities Markets Programme (SMP), and, if necessary, the seigniorage income from euro banknotes, in full or in part, if the amount to be distributed exceeds the ECB’s net profit for the year. Subject to a decision to that effect by the ECB Governing Council, the amount concerned may be reduced by the expenses of the ECB arising from the issue and handling of euro banknotes; in addition, it may be added to a provision for foreign exchange rate, interest rate and gold price risks. The amount distributed to DNB is presented in the Profit and Loss Account under ‘Income from ordinary shares and other equity’.

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4 The year of cash changeover is the year in which the Member State concerned introduces euro banknotes as legal tender.
5 The reference period is the 24-month period starting 30 months prior to the date on which euro banknotes will become legal tender in a particular Member State.
Recognition of income and expenses
Income and expenses are recognised in the period in which they are earned or incurred. Realised gains and losses on investments are presented according to the average cost method in the Profit and Loss Account, except those concerning held-to-maturity securities, which are valued at amortised cost including any unusual depreciation. In the event that re-marking to market yields an unrealised loss on any security as at year-end, the average price of that security is reduced in line with the end-of-year market price and exchange rate.

Unrealised gains are not recognised as income, but are transferred directly to the revaluation accounts. Unrealised losses are taken to the Profit and Loss Account to the extent that they exceed the balance of the corresponding revaluation accounts. These unrealised losses are not netted against any unrealised gains in later years.

Pension and other retirement schemes
The pension rights of staff and former staff of DNB and PVK as well as of other eligible persons have been transferred to Stichting Pensioenfonds van De Nederlandsche Bank NV (DNB Pension Fund). Through an agreement, DNB has undertaken to pay to the DNB Pension Fund, subject to conditions agreed for the purpose, such amounts as to ensure the pensions under the Pension Fund’s pension schemes. In the agreement, the financial methodology is set out in a premium, supplement and risk policy ladder; in the target assets, allowance is made for the indexation ambition.

The level of the amounts payable by DNB and the liabilities disclosed in the financial statements in respect of other retirement schemes are calculated on an actuarial basis.
2. Notes to the balance sheet

Assets

1. Gold and gold receivables
In the year under review, the gold stock, including the gold receivables, did not change. The gold stock on the last business day of the financial year consisted of some 19.7 million fine troy ounces (or about 612 tonnes) of gold at a market value of EUR 871.22 (year-end 2012: EUR 1,261.18) per fine troy ounce. The euro value of this item has declined compared to 2012 due to a drop in the market price of gold.

 Millions

<table>
<thead>
<tr>
<th></th>
<th>EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Position as at 31 December 2011</td>
<td>23,961</td>
</tr>
<tr>
<td>Revaluation of gold stock 2012</td>
<td>-873</td>
</tr>
<tr>
<td>Position as at 31 December 2012</td>
<td>24,834</td>
</tr>
<tr>
<td>Revaluation of gold stock 2013</td>
<td>-7,679</td>
</tr>
<tr>
<td>Position as at 31 December 2013</td>
<td>17,155</td>
</tr>
</tbody>
</table>

2. Claims on non-euro area residents denominated in foreign currency
This item, amounting to EUR 16,198 million as at year-end 2013 (year-end 2012: EUR 16,414 million) breaks down as follows:

- 2.1 Receivables from the International Monetary Fund (IMF)
On the last business day of the financial year, the receivables stood at SDR 7,346 million at the rate of EUR 0.8942 (year-end 2012: EUR 0.8579).

 Millions

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SDR</td>
<td>EUR</td>
</tr>
<tr>
<td>Special drawing rights</td>
<td>4,560</td>
<td>5,099</td>
</tr>
<tr>
<td>Reserve tranche position</td>
<td>1,345</td>
<td>1,505</td>
</tr>
<tr>
<td>Loans</td>
<td>1,441</td>
<td>1,612</td>
</tr>
<tr>
<td>Total</td>
<td>7,346</td>
<td>8,216</td>
</tr>
</tbody>
</table>

As at year-end 2013, Special Drawing Rights amounted to EUR 5,099 million (year-end 2012: EUR 5,433 million). Special Drawings Rights represent the right, in the event of balance-of-payments problems, to exchange (part of) the SDR holdings to obtain other currencies, such as USD or EUR. These rights were created against liability item 7, ‘Counterpart of special drawings rights allocated by the IMF’ of EUR 5,409 million (year-end 2012: EUR 5,638 million).

The reserve tranche position of EUR 1,505 million (year-end 2012: EUR 1,829 million) concerns the funds provided by DNB to the IMF for lending by the IMF through the General Resources Account (GRA). IMF Member Countries are required to make at least 25% of their quota available in the
form of gold or convertible currencies. The Dutch quota, for which DNB acts as manager/agent, equals SDR 5,162 million. In 2010, it was decided to increase the quota, which will result in a higher reserve tranche position through the transfer of 25% of the enlargement. The effective date of the quota increase is uncertain because the largest member of the IMF – the United States of America – has not ratified the change. Once the change has been enacted, the Dutch quota will increase by SDR 3.6 billion. The IMF remunerates this position at an interest rate which is updated weekly. In 2013, this rate was between 0.03% and 0.13% on an annual basis (2012: between 0.03% and 0.15%). This rate reflects the prevailing SDR interest rate.

The loans (EUR 1,612 million) consist of a loan to the Poverty Reduction and Growth Facility-Exogenous Shock Facility Trust (PRGF-ESF Trust) and a special bilateral loan arrangement which was included in 2010 in the New Arrangements to Borrow (NAB). The PRGF-ESF Trust (EUR 298 million) is a fund set up to supply the principals of subsidised low-interest loans to the poorest developing countries. The Netherlands has pledged SDR 500 million to the ‘PRGF loan account’. In respect of these amounts, a contract was agreed with the IMF entailing that each drawing must be repaid in ten equal tranches within 5.5 to 10 years after the drawing. DNB receives the prevailing market rate on the loan; the interest rate subsidy is financed by the Ministry of Foreign Affairs.

Under the NAB (EUR 1,314 million), a credit line with a maximum of EUR 10.1 billion has been made available for use by the IMF for its regular operations in addition to the regular quota. In 2011, it was decided to increase the financial efficacy of the IMF through new bilateral loans totalling EUR 456 billion. Of this, euro countries are to shoulder EUR 150 billion. The contribution of the Netherlands, EUR 13.6 billion, was effected in 2012. The IMF has not yet drawn on this facility. The new bilateral loans will function as the IMF’s last financial line of defence in case the quota and the NAB both face exhaustion. Since DNB is the executing body of the Dutch IMF membership, credit guarantees up to the sum of the maximum commitment for each facility have been granted by the Dutch State.

- 2.2 Balances held with banks and investments in securities, external loans and other external assets

In 2013 this item increased from EUR 7,547 million to EUR 7,982 million.

The item breaks down as follows:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign currency</td>
<td>EUR</td>
<td>Exchange rate</td>
</tr>
<tr>
<td>USD</td>
<td>9,153</td>
<td>6,637</td>
</tr>
<tr>
<td>JPY</td>
<td>59,017</td>
<td>408</td>
</tr>
<tr>
<td>AUD</td>
<td>1,445</td>
<td>937</td>
</tr>
<tr>
<td>Other currencies</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,982</strong></td>
<td><strong>7,547</strong></td>
</tr>
</tbody>
</table>
These foreign currency balances break down by investment category as follows:

Millions

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Fixed-income securities</td>
<td>7,301</td>
<td>6,697</td>
</tr>
<tr>
<td>Reverse repurchase agreements</td>
<td>676</td>
<td>814</td>
</tr>
<tr>
<td>Deposits</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Nosto accounts</td>
<td>5</td>
<td>34</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,982</strong></td>
<td><strong>7,547</strong></td>
</tr>
</tbody>
</table>

The maturities of the fixed-income securities can be presented as follows:

Millions

<table>
<thead>
<tr>
<th></th>
<th>Residual maturity as at 31 December 2013</th>
<th>Residual maturity as at 31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>0 - 1 year</td>
</tr>
<tr>
<td>USD</td>
<td>6,119</td>
<td>2,601</td>
</tr>
<tr>
<td>JPY</td>
<td>408</td>
<td>408</td>
</tr>
<tr>
<td>AUD</td>
<td>774</td>
<td>440</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>7,301</td>
<td>3,449</td>
</tr>
</tbody>
</table>

For each investment, the residual maturity is the period from the balance sheet date to the expiration date.

3. Claims on euro area residents denominated in foreign currency

As at year-end 2013, this item stood at nil (year-end 2012: EUR 152 million, consisting solely of reverse repurchase agreements denominated in USD).

4. Claims on non-euro area residents denominated in euro

As at year-end 2013, this item totalled EUR 243 million (year-end 2012: EUR 185 million), consisting of short-term liabilities other than deposits.

5. Lending to euro area credit institutions related to monetary policy operations, denominated in euro

Together, asset item 5 and liability item 2 relate to euro area monetary policy insofar as it is implemented by DNB on behalf of the Eurosystem. The amount of this item depends on the liquidity need of Dutch-based credit institutions bidding on monetary policy operations through DNB.

As at year-end 2013, the Eurosystem’s total claim arising from the item ‘Lending to euro area credit institutions related to monetary policy operations denominated in euro’ amounted to EUR 752,288 million (year-end 2012: EUR 1,128,794 million). Of this total, lending by DNB to Dutch-based credit institutions amounted to EUR 119,941 million (year-end 2012: EUR 703,691 million).

7 To hedge against inherent credit and interest rate risks, the State has extended a partial guarantee (see: ‘Guarantee scheme for crisis-related assets’ on page 171).
Financial statements

Institutions amounted to EUR 8,814 million as at year-end 2013 (year-end 2012: EUR 24,511 million). In accordance with Article 32.4 of the ESCB Statute, all risks relating to such lending will, if materialised, be borne in toto by the Eurosystem NCBs in proportion to the ECB capital key in force at the time when the loss is incurred. To have access to this facility, a financial institution must meet the requirements made by the ECB, including the collateral eligibility criteria. Losses occur only if the counterparty defaults on the repayment and, in addition, the sale of the collateral fails to cover the debt. It should be noted here that national central banks may temporarily accept supplementary collateral that fails to meet the eligibility standards. Any losses on such collateral will not be shared across the ESCB. In 2012, DNB did not have reason to accept supplementary collateral.

- **5.1 Main refinancing operations**
  Main refinancing operations, nil at year-end 2013 (year-end 2012: EUR 32 million), meet part of the financial sector’s refinancing needs. They are conducted as standard tenders on a weekly basis, usually with a maturity of one week. Since October 2008, these operations have been conducted on a fixed-rate basis. All eligible counterparties may enter bids. In 2013, all main refinancing operations were conducted as fixed-rate tenders with full allotment. The interest rate applied is the key policy rate adopted by the ECB Governing Council. In 2013, the average return on the main refinancing operations was 0.6% (2012: 0.9%).

- **5.2 Longer-term refinancing operations**
  Longer-term refinancing operations, amounting to EUR 8,814 million as at year-end 2013 (year-end 2012: 24,479 million), are refinancing operations which provide longer-term liquidity. They are usually conducted on a monthly basis, with a maturity of three months. In addition, two longer-term refinancing operations were conducted in December 2011 and February 2012 with maturities of approximately 36 months. The longer-term refinancing operations were conducted as fixed-rate tenders at a rate equalling the average of the rates applied in the main refinancing operations over the life of the respective operations. In 2013, the average return on the longer-term refinancing operations was 0.6% (2012: 0.9%). Banks were given the opportunity to opt for early redemption of these refinancing loans as of one year into their life span, and in 2013 used this opportunity.

- **5.3 Fine-tuning reverse transactions**
  Fine-tuning reverse transactions, position nil at year-end 2013 (year-end 2012: nil), are conducted both regularly and irregularly in order to provide extra liquidity to the market on an ad-hoc basis. Fine-tuning reverse operations are usually conducted by the NCBs as quick tenders. As in 2012, no such operations were conducted in 2013.

- **5.4 Structural reverse operations**
  The ECB is empowered to conduct these operations in order to adjust the structural position of the ESCB vis-à-vis the financial sector. As in 2012, no such operations were conducted in 2013.

- **5.5 Marginal lending facility**
  Counterparties may use this facility (amount outstanding nil as at both year-end 2013 and year-end 2012), to obtain overnight liquidity from NCBs at a predetermined interest rate against the usual collateral. In 2013, the average return on the marginal lending facility was 1.6% (2012: 0.0%). In 2013, as in 2012, recourse to this facility remained very limited.
5.6 Credits related to margin calls
In 2013, as in 2012, no credits related to margin calls were extended.

6. Other claims on euro area credit institutions denominated in euro
At year-end 2013, this item amounted to EUR 100 million (year-end 2012: nil), consisting solely of reverse repurchase agreements.

7. Securities of euro area residents denominated in euro
As at year-end 2013, this item totalled EUR 30,176 million (year-end 2012: EUR 26,663 million); it consists of 'Securities held for monetary policy purposes' and 'Other securities'.

7.1 Securities held for monetary policy purposes
This item represents securities obtained by DNB in the context of programmes for the purchase of covered bonds, and sovereign debt securities obtained under the Securities Markets Programme (SMP).9 10

Millions

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Securities Markets Programme</td>
<td>10,196</td>
<td>11,395</td>
</tr>
<tr>
<td>Covered Bond Purchase Programme 1</td>
<td>2,171</td>
<td>2,647</td>
</tr>
<tr>
<td>Covered Bond Purchase Programme 2</td>
<td>674</td>
<td>736</td>
</tr>
<tr>
<td>Total</td>
<td>13,041</td>
<td>14,778</td>
</tr>
</tbody>
</table>

The maturities of the fixed-income securities can be presented as follows:

Millions

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>0 - 1 year</td>
</tr>
<tr>
<td></td>
<td>EUR</td>
<td>3,558</td>
</tr>
</tbody>
</table>

Under the Securities Markets Programme (SMP), the ECB and the national central banks of the Eurosystem were enabled to purchase debt securities issued by euro area governments and private organisations to improve the functioning of certain segments of the euro area capital markets and to restore the smooth operation of the monetary policy transmission mechanism. In September 2012, the Governing Council of the ECB decided to terminate this programme.


10 To hedge the inherent credit and interest rate risk, the State has extended a partial guarantee (see: ‘Guarantee scheme for crisis-related assets’ on page 171).
The total holdings of securities held by the national central banks of the Eurosystem in the context of the SMP amount to EUR 178,836 million (year-end 2012: EUR 192,252 million). As at year-end 2013, such securities held by DNB amounted to EUR 10,196 million (year-end 2012: EUR 11,395 million). In conformity with Article 32.4 of the ESCB Statute, all risks relating to this lending will, once they manifest themselves, completely by the Eurosystem’s NCBs in proportion to the ECB capital key applying at the time when a loss is incurred.

Under the Covered Bond Purchase Programmes (CBPP1 and CBPP2), the ECB and the Eurosystem NCBs, including DNB, purchased euro-denominated covered bonds issued in the euro area. The aim was to ease the funding conditions for credit institutions and enterprises, and to encourage credit institutions to maintain and expand their lending to clients. Both programmes have been formally discontinued: no new purchases are made under these programmes.

Securities purchased under the Securities Markets Programme (SMP) and those purchased under the Covered Bond Purchase Programmes (CBPP1 and CBPP2) have been designated as held to maturity and are presented at amortised cost less any impairment.

The annual test to determine any impairment is performed by the Eurosystem on the basis of the accounting policies applicable to the European System of Central Banks (see under ‘Accounting policies’ above), the available information and the expected realisable value as at balance sheet date. This is in accordance with a Decision by the ECB Governing Council, which DNB observes. As regards the securities purchased under the Securities Markets Programme (SMP) and under the Covered Bond Purchase Programmes (CBPP1 and CBPP2), no impairment have been made either.

Although the ESCB tests did not result in any impairment on these positions, considerable risks due to the debt crisis remain and may still give rise to losses. The Governing Council of the ECB and the Governing Board of DNB regularly assess the financial risks attaching to the securities held in the SMP and CBPP portfolios. Section 5.6 of the Annual Report provides a more detailed discussion on various risks including the risk inherent in these portfolios.

- 7.2 Other securities
As at year-end 2013, this item totalled EUR 17,135 million (year-end 2012: EUR 11,785 million) and consisted, as in 2012, entirely of fixed-income securities.

The part of ‘Other securities’ consisting of securities valued at amortised cost has been reclassified as marked to market, which facilitates more effective control of interest rate and credit risks. At the same time, the positive intent to hold these securities to maturity was relinquished. The papers will be sold at an expedient moment given the target risk profile of the entire portfolio.

In 2013 it was decided to transfer the fixed-income securities from ‘Other financial assets’ to ‘Other securities’. The reason is that the transfer made the management of the risks on such paper more effective and efficient, and risk developments regarding the portfolio easier to anticipate.

The said transfer led to a one-off value transfer of EUR 5,444 million at the time of transfer. The reclassification of the amortised cost-valued part of ‘Other
securities’ (EUR 3,379 million) as marked to market (EUR 3,547 million) resulted in a one-off increase of EUR 168 million at that time. This amount was acknowledged in full in the ‘Revaluation accounts’.

### Financial statements

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- marked to market</td>
<td>17,135</td>
<td>8,263</td>
</tr>
<tr>
<td>- valued at amortised cost</td>
<td>0</td>
<td>3,522</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17,135</strong></td>
<td><strong>11,785</strong></td>
</tr>
</tbody>
</table>

The maturities of the fixed-income securities can be presented as follows:

<table>
<thead>
<tr>
<th>Residual maturity as at 31 December 2013</th>
<th>Residual maturity as at 31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>0 - 1 year</td>
</tr>
<tr>
<td>-----</td>
<td>------------</td>
</tr>
<tr>
<td>17,135</td>
<td>8,551</td>
</tr>
</tbody>
</table>

8. Claims within the Eurosystem

As at year-end 2013, this item totalled EUR 82,791 million (year-end 2012: EUR 153,195 million).

- 8.1 Participating interest in the ECB

This item represents DNB’s participating interest in the ECB of EUR 469 million (year-end 2012: EUR 469 million), including EUR 40 million worth of premium. According to Article 28 of the ESCB Statute, the national central banks of the ESCB are the only shareholders in the capital of the ECB. Each NCB’s capital interest depends on its share fixed in accordance with Article 29.3 of the ESCB Statute. This share is reviewed every five years. The capital interests in the ECB are valued at purchase price.

On 1 July 2013, the capital key was adjusted to reflect the accession of Croatia to the EU. Under Section 48.3 of the ESCB Statute, the paid-up capital of the ECB is increased automatically whenever a new State joins the EU and, by consequence, its central bank joins the ESCB. The increase is determined by multiplying the prevailing amount of the subscribed capital (i.e. EUR 10,825 million) by the ratio, within the expanded capital key, between the weighting of the entering NCB(s) and the weighting of those NCBs that are already members of the ESCB. As a consequence, the subscribed capital of the ECB was increased on 1 July 2013, from EUR 10,760 million to EUR 10,825 million. The result was that the share of DNB in the increased subscribed capital of the ECB (EUR 429 million) decreased from 3.9882% to 3.9663%, whereas asset item 8.1 ‘Participating interest in the ECB’ increased by EUR 0.8 million to EUR 469.4 million.
The NCBs’ shares in the authorised, subscribed and paid up capital of the ECB are as follows:

<table>
<thead>
<tr>
<th>Nations Bank van België</th>
<th>Deutsche Bundesbank</th>
<th>Eesti Pank</th>
<th>Central Bank and Financial Services</th>
<th>Authority of Ireland</th>
<th>Bank of Greece</th>
<th>Banco de España</th>
<th>Banque de France</th>
<th>Banca d’Italia</th>
<th>Central Bank of Cyprus</th>
<th>Banque centrale du Luxembourg</th>
<th>Central Bank of Malta</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>%</td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.4757</td>
<td>2.4176</td>
<td>261</td>
<td>261</td>
<td>262</td>
<td>262</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>26.9707</td>
<td>18.7603</td>
<td>2,038</td>
<td>2,038</td>
<td>2,031</td>
<td>2,031</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.2559</td>
<td>0.1780</td>
<td>19</td>
<td>19</td>
<td>19</td>
<td>19</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>1.5974</td>
<td>1.1111</td>
<td>119</td>
<td>119</td>
<td>120</td>
<td>120</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.8010</td>
<td>1.9483</td>
<td>211</td>
<td>211</td>
<td>211</td>
<td>211</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11.8653</td>
<td>8.2533</td>
<td>894</td>
<td>894</td>
<td>893</td>
<td>893</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20.3200</td>
<td>14.1342</td>
<td>1,530</td>
<td>1,530</td>
<td>1,530</td>
<td>1,530</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17.9088</td>
<td>12.4570</td>
<td>1,345</td>
<td>1,345</td>
<td>1,348</td>
<td>1,348</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.1916</td>
<td>0.1333</td>
<td>15</td>
<td>15</td>
<td>14</td>
<td>14</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.2500</td>
<td>0.1739</td>
<td>19</td>
<td>19</td>
<td>19</td>
<td>19</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.0913</td>
<td>0.0635</td>
<td>7</td>
<td>7</td>
<td>7</td>
<td>7</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>5.7021</strong></td>
<td><strong>3.9663</strong></td>
<td><strong>429</strong></td>
<td><strong>429</strong></td>
<td><strong>429</strong></td>
<td><strong>429</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Oesterreichische Nationalbank</strong></td>
<td><strong>2.7847</strong></td>
<td><strong>1.9370</strong></td>
<td><strong>209</strong></td>
<td><strong>209</strong></td>
<td><strong>210</strong></td>
<td><strong>210</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Banco de Portugal</strong></td>
<td><strong>2.5354</strong></td>
<td><strong>1.7636</strong></td>
<td><strong>188</strong></td>
<td><strong>188</strong></td>
<td><strong>191</strong></td>
<td><strong>191</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Banka Slovenije</strong></td>
<td><strong>0.4701</strong></td>
<td><strong>0.3270</strong></td>
<td><strong>35</strong></td>
<td><strong>35</strong></td>
<td><strong>35</strong></td>
<td><strong>35</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Národná banka Slovenska</strong></td>
<td><strong>0.9892</strong></td>
<td><strong>0.6881</strong></td>
<td><strong>75</strong></td>
<td><strong>75</strong></td>
<td><strong>75</strong></td>
<td><strong>75</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Suomen Pankki-Finlands Bank</strong></td>
<td><strong>1.7907</strong></td>
<td><strong>1.2456</strong></td>
<td><strong>135</strong></td>
<td><strong>135</strong></td>
<td><strong>135</strong></td>
<td><strong>135</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Total euro area NCBs | 100.0000 | 69.5581 | 7,529 | 7,529 | 7,529 | 7,529 |
| Bulgarian National Bank | - | 0.8644 | 93 | 3 | 94 | 3 |
| Ceská národní banka | - | 1.4539 | 156 | 6 | 157 | 6 |
| Danmarks Nationalbank | - | 1.4754 | 160 | 6 | 160 | 6 |
| Hrvatska Narodna banka | - | 0.5945 | 0 | 0 | 65 | 2 |
| Latvijas Banka | - | 0.2742 | 30 | 1 | 30 | 1 |
| Lietuvos bankas | - | 0.4093 | 46 | 2 | 44 | 2 |
| Magyar Nemzeti Bank | - | 1.3740 | 149 | 6 | 149 | 6 |
| Narodowy Bank Polski | - | 4.8581 | 527 | 20 | 525 | 20 |
| Banca Natională a României | - | 2.4449 | 265 | 10 | 265 | 10 |
| Sveriges Riksbank | - | 2.2612 | 243 | 9 | 245 | 9 |
| Bank of England | - | 14.4320 | 1,562 | 58 | 1,562 | 59 |

| Total non-euro area NCBs | - | 30.4419 | 3,231 | 121 | 3,296 | 124 |

| Total euro area and non-euro area NCBs | - | 100.0000 | 10,760 | 7,650 | 10,825 | 7,653 |

- 8.2 Claims equivalent to the transfer of foreign reserves to the ECB
These claims arise from the transfer of foreign reserves to the ECB. The interest paid on these claims is calculated daily at the latest available rate used in the main refinancing operations of the Eurosystem. The gold component is unremunerated.
- 8.4 (asset item) / 8.2 (liability item) Other claims/liabilities within the Eurosystem (net)

<table>
<thead>
<tr>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Claims on the ECB arising from TARGET2 (including balances held with the Eurosystem in correspondent accounts)</td>
<td>46,115</td>
</tr>
<tr>
<td>Liabilities to the ECB arising from monetary income</td>
<td>-484</td>
</tr>
<tr>
<td>Claims on the ECB arising from the ECB’s interim profit distribution</td>
<td>78</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>45,709</strong></td>
</tr>
</tbody>
</table>

The level of this claim/liability depends on three components:
1) DNB’s position vis-à-vis the ECB resulting from payments to and from NCBs and the ECB through TARGET2;
2) DNB’s position vis-à-vis the ECB arising from intra-Eurosystem pooling and allocation of monetary income; and
3) DNB’s position vis-à-vis the ECB arising from other amounts received or paid, including DNB’s share in interim profit distributions by the ECB.

The first component gives rise to a TARGET2 claim of EUR 46,115 million (year-end 2012: EUR 120,772 million). The interest paid on these claims is calculated daily at the latest available rate used in the main refinancing operations of the Eurosystem. The second component, i.e. DNB’s position vis-à-vis the ECB due to the annual pooling and redistribution of monetary income by the Eurosystem NCBs shows a net credit of EUR 484 million at the end of the year (see ‘Net result of monetary income pooling’ in the notes to the Profit and Loss Account).

In 2013 the Governing Council of the ECB decided to distribute interim profits of EUR 1,370 million to the euro area NCBs. DNB’s accrual on year-end 2013 was EUR 78 million (see ‘Income from equity shares and participating interests’ in the Profit and Loss Account).

Using a netting technique developed within the Eurosystem, the ECB determines each country’s net position (claims/liabilities) vis-à-vis the ECB on account of transfer of payments on a daily basis. A net claim of DNB is shown under ‘Other claims within the Eurosystem (net)’ (asset item 8.4). A net liability of DNB is shown under ‘Other liabilities within the Eurosystem (net)’ (liability item 8.2). As at year-end 2013, DNB had a net claim of EUR 45,709 million (year-end 2012: a net claim of EUR 119,860 million). The decline was due to the decrease in the amount of surplus liquidity held by commercial banks with DNB.

- 8.5 Net claims related to the allocation of euro banknotes within the Eurosystem
This item, of EUR 34,314 million (year-end 2012: EUR 30,569 million), consists of a net claim of DNB on the Eurosystem relating to the reallocation of euro banknotes (see ‘Banknotes in circulation’ and ‘Net claims related to the allocation of euro banknotes within the Eurosystem’ under ‘Accounting policies’).

The increase compared to 2012 (by EUR 3,745 million) is due to a 5% growth of the banknotes in circulation within the Eurosystem as a whole. The interest paid
on these claims is calculated daily at the latest available rate used in the main refinancing operations of the Eurosystem.\textsuperscript{11}

9. Other assets
As at year-end 2013, this item totalled EUR 3,051 million (year-end 2012: EUR 8,538 million).

- 9.2 Tangible and intangible fixed assets
The sub-items included in this item break down as follows:

<table>
<thead>
<tr>
<th></th>
<th>Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
</tr>
<tr>
<td>Total tangible and intangible fixed assets</td>
<td></td>
</tr>
<tr>
<td>Book value as at 1 January 2013</td>
<td>250</td>
</tr>
<tr>
<td>Changes:</td>
<td></td>
</tr>
<tr>
<td>Reclassification</td>
<td>-</td>
</tr>
<tr>
<td>Investments</td>
<td>27</td>
</tr>
<tr>
<td>Disinvestments</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation</td>
<td>-30</td>
</tr>
<tr>
<td>Impairment</td>
<td>-1</td>
</tr>
<tr>
<td>Book value as at 31 December 2013</td>
<td>246</td>
</tr>
<tr>
<td>Prices or production prices</td>
<td>543</td>
</tr>
<tr>
<td>Cumulative depreciation</td>
<td>-297</td>
</tr>
<tr>
<td>Book value as at 31 December 2013</td>
<td>246</td>
</tr>
</tbody>
</table>

- 9.3 Other financial assets
In terms of currencies, the items included in ‘Other financial assets' break down as follows:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>USD</td>
<td>309</td>
<td>275</td>
</tr>
<tr>
<td>Other foreign currencies</td>
<td>414</td>
<td>413</td>
</tr>
<tr>
<td>EUR</td>
<td>1,133</td>
<td>6,280</td>
</tr>
<tr>
<td>Total</td>
<td>1,856</td>
<td>6,968</td>
</tr>
</tbody>
</table>

\textsuperscript{11} According to the accounting regime chosen by the Eurosystem on the issue of euro banknotes, a share of 8% of the total value of the euro banknotes in circulation is allocated to the ECB on a monthly basis. The remaining 92% of the value of the euro banknotes in circulation are allocated to the NCBs also on a monthly basis, and each NCB discloses in its balance sheet a share of the euro banknotes issued corresponding to its paid-up share in the ECB’s capital. The difference between the value of the euro banknotes allocated to the NCB according to the aforementioned accounting regime, and the value of euro banknotes put into circulation, is recorded as a 'Net Intra-Eurosystem claim/liability related to the allocation of euro banknotes within the Eurosystem.'
Financial statements

‘Other financial assets’ can be sub-classified as follows:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Participating interests</td>
<td>61</td>
<td>61</td>
</tr>
<tr>
<td>Fixed-income securities</td>
<td>0</td>
<td>4,996</td>
</tr>
<tr>
<td>Equities</td>
<td>1,608</td>
<td>1,560</td>
</tr>
<tr>
<td>Reverse repurchase agreements</td>
<td>0</td>
<td>150</td>
</tr>
<tr>
<td>Other claims</td>
<td>187</td>
<td>201</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,856</strong></td>
<td><strong>6,968</strong></td>
</tr>
</tbody>
</table>

The participating interests mentioned are those in the Bank for International Settlements (BIS), the Society for Worldwide Interbank Financial Telecommunications scrl (SWIFT), and NV Settlement Bank of the Netherlands (SBN). The participation ratios are unchanged from 2012.

The BIS shares are 25% paid-up; as at the balance sheet date, the contingent liability for calls was SDR 64.9 million (year-end 2012: SDR 64.9 million). Although DNB holds 100% of the shares in the SBN, this entity is not consolidated into DNB’s financial statements. The reason is that DNB cannot exercise any significant influence within SBN, which is entirely controlled by external parties.

<table>
<thead>
<tr>
<th>Participating interests</th>
<th>% share</th>
<th>Location</th>
<th>Participating interest's paid-up capital *)</th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>BIS</td>
<td>3.09</td>
<td>Basel (Switzerland)</td>
<td>20,554</td>
<td>52</td>
<td>52</td>
</tr>
<tr>
<td>SWIFT scrl</td>
<td>0.06</td>
<td>La Hulpe (Belgium)</td>
<td>252</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>NV SBN</td>
<td>100</td>
<td>Amsterdam</td>
<td>9</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>61</strong></td>
<td><strong>61</strong></td>
</tr>
</tbody>
</table>

* Capital of SWIFT scrl and NV SBN on the basis of the 2012 annual statements. Capital of the BIS based on the 2013 annual statement (financial year from 1 April 2012 through 31 March 2013).

The fixed-income securities were this year transferred to the euro portfolio, with zero net effect, and are now represented under item 7.2, ‘Other securities’.
The maturities of the fixed-income securities can be presented as follows:

<table>
<thead>
<tr>
<th></th>
<th>Residual maturity as at 31 December 2013</th>
<th>Residual maturity as at 31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>0 - 1 year</td>
</tr>
<tr>
<td>EUR</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

The equities consist of stock index investments.

‘Other claims’ include claims arising from mortgage loans extended to DNB staff.

The reverse repurchase agreements, deposits and other claims have maturities of less than one year.

- **9.4 Off-balance sheet instruments revaluation differences**
  This balance sheet item presents currency revaluation differences in respect of the off-balance sheet instruments. As at year-end 2013, this item totalled EUR 292 million (net) (year-end 2012: EUR 356 million). A breakdown is presented in the overview of off-balance sheet positions in respect of currency swaps and currency forwards, on page 170).

- **9.5 Accruals and prepaid expenses**
  As at year-end 2013, this item totalled EUR 646 million (year-end 2012: EUR 943 million). These items consist almost entirely of accrued interest and unamortised forward returns.

The unamortised returns break down as follows:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Currency swaps</td>
<td>8</td>
<td>16</td>
</tr>
<tr>
<td>Currency forwards</td>
<td>-4</td>
<td>-2</td>
</tr>
<tr>
<td>Interest rate swaps</td>
<td>-7</td>
<td>-34</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-3</strong></td>
<td><strong>-20</strong></td>
</tr>
</tbody>
</table>
Liabilities

1. Banknotes in circulation
This item represents DNB’s share in the total euro banknotes circulated by the Eurosystem (see ‘Banknotes in circulation’ under ‘Valuation and accounting policies’ above).

The composition of banknotes put into circulation by DNB less banknotes returned to DNB, by denomination, is as follows.

<table>
<thead>
<tr>
<th>Number</th>
<th>EUR</th>
<th>Number</th>
<th>EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR 5</td>
<td>-90</td>
<td>-452</td>
<td>-76</td>
</tr>
<tr>
<td>EUR 10</td>
<td>-82</td>
<td>-824</td>
<td>-65</td>
</tr>
<tr>
<td>EUR 20</td>
<td>-400</td>
<td>-8,009</td>
<td>-362</td>
</tr>
<tr>
<td>EUR 50</td>
<td>410</td>
<td>20,485</td>
<td>390</td>
</tr>
<tr>
<td>EUR 100</td>
<td>-4</td>
<td>-398</td>
<td>-2</td>
</tr>
<tr>
<td>EUR 200</td>
<td>31</td>
<td>6,122</td>
<td>31</td>
</tr>
<tr>
<td>EUR 500</td>
<td>-2</td>
<td>-1,077</td>
<td>0</td>
</tr>
</tbody>
</table>

Total euro banknotes circulated by DNB 15,847 17,287

Reallocation of euro banknotes in circulation 38,676 34,730

Euro banknotes allocated to the ECB (8% of 15,847 + 38,676) -4,362 -4,161

34,314 30,569

50,161 47,856

This item increased by EUR 2,305 million owing to an increase in the number of euro banknotes issued by the national central banks of the Eurosystem. The negative numbers of banknotes for certain denominations are explained by the fact that, on a net basis, DNB issued fewer of these banknotes than it received from circulation.

2. Liabilities denominated in euro to euro area credit institutions in connection with monetary policy operations
Together, liability item 2 and asset item 5 relate to the monetary policy in the euro area insofar as it is implemented by DNB. Liability item 2 relates to interest-bearing liabilities to credit institutions arising from the money market policy conducted by DNB on behalf of the ESCB. As at year-end 2013, this item was EUR 84,100 million lower than as at year-end 2012 (year-end 2013: EUR 73,938 million, year-end 2012: EUR 158,038 million).

‘Liabilities to euro area credit institutions related to monetary policy operations denominated in euro’ as at year-end 2013 and year-end 2012, respectively, were as follows.

- 2.1 Current accounts (covering the minimum reserve system)
These liabilities, amounting to EUR 37,866 million as at year-end 2013 (year-end 2012: EUR 87,393 million), relate to the amounts held by banks in accounts at
DNB, including amounts held in order to meet their obligations under the minimum reserve system. Interest is paid on these compulsory reserve holdings at a rate equal to the average marginal rate in the main refinancing operations during the reserve maintenance period. No interest is paid on ‘excess reserves’. In 2013, an average interest rate of 0.1% was paid on the current accounts (2012: 0.2%).

- **2.2 Deposit facility**
  This permanent facility, amounting to EUR 9,157 million as at year-end 2013 (year-end 2012: EUR 14,370 million), may be used by credit institutions to place overnight deposits at DNB at a predetermined interest rate. After the interest rate on this facility was reduced to 0% in mid-2012, banks had less recourse to it and held major parts of their excess reserves in current accounts. In 2013, the average interest rate on the deposit facility was 0.0% (2012: 0.2%).

- **2.3 Fixed-term deposits**
  These are deposits placed at DNB, amounting to EUR 26,915 million as at year-end 2013 (year-end 2012: EUR 36,075 million). This balance sheet item covers the liquidity-absorbing operations that are conducted weekly by the Eurosystem to offset the liquidity effects of the Securities Markets Programme (SMP), as well as the Eurosystem’s fine-tuning operations intended to absorb excess liquidity. In 2013, an average interest rate of 0.1% was paid on the fixed-term deposits (2012: 0.2%).

- **2.4 Fine-tuning reverse transactions**
  These are monetary policy operations intended to tighten liquidity. In 2013, as in 2012, no fine-tuning reverse operations were effected.

- **2.5 Deposits related to margin calls**
  These are deposits made by credit institutions to compensate depreciation of securities pledged as collateral for credits granted. In 2013, as in 2012, no deposits related to margin calls were held.

3. **Liabilities to other euro area residents denominated in euro**
   This item, amounting to EUR 965 million (year-end 2012: EUR 134 million), consists mainly of other liabilities to financial institutions and margin cash collateral to euro area residents.

4. **Liabilities to non-euro area residents denominated in euro**
   This item, amounting to EUR 1,774 million (year-end 2012: EUR 5,873 million), consists mainly of other liabilities to financial institutions and collateral pledged to euro area residents.

6. **Liabilities to non-euro area residents denominated in foreign currency**
   As at year-end 2013, this item stood at EUR 315 million (year-end 2012: nil), including mainly repurchase agreements.

7. **Counterpart of special drawing rights allocated by the IMF**
   This item is explained under asset item 2.1.

9. **Other liabilities**
   As at year-end 2013, total other liabilities amounted to EUR 116 million (year-end 2012: EUR 2,751 million).

Millions

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Provision for monetary policy operations</th>
<th>Provision for staff remuneration</th>
<th>Other provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Position as at 31 December 2011</td>
<td>73</td>
<td>53</td>
<td>12</td>
<td>8</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>-4</td>
<td>0</td>
<td>-1</td>
<td>-3</td>
</tr>
<tr>
<td>Release</td>
<td>-39</td>
<td>-36</td>
<td>-2</td>
<td>-1</td>
</tr>
<tr>
<td>Addition</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Position as at 31 December 2012</td>
<td>32</td>
<td>17</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>-3</td>
<td>0</td>
<td>-1</td>
<td>-2</td>
</tr>
<tr>
<td>Release</td>
<td>-18</td>
<td>-17</td>
<td>0</td>
<td>-1</td>
</tr>
<tr>
<td>Addition</td>
<td>4</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Position as at 31 December 2013</td>
<td>15</td>
<td>0</td>
<td>12</td>
<td>3</td>
</tr>
</tbody>
</table>

- Provision for monetary policy operations
In conformity with Article 32.4 of the ESCB Statute, the provision against the risk of default on the part of counterparties has been divided within the Eurosystem among the national central banks of the participating Member States in proportion to their capital key in the year of default. Having assessed the size of this provision in accordance with general accounting policies, the Governing Council of the ECB has decided to release it. The residual amount of the provision was EUR 310 million. For DNB this resulted in a release of EUR 17 million to profit (see also ‘Net result of monetary income pooling’ in the notes to the Profit and Loss Account’).

- Provision for staff remuneration
DNB operates the following arrangements:
- a defined benefit pension arrangement;
- a contribution to the health care insurance premiums of pensioners (limited group);
- a (limited) inactivity arrangement;
- a service anniversary and retirement bonus arrangement;
- a redundancy programme.

The pension scheme is an index-linked career-average scheme, with guaranteed indexation in line with general wage increases. Pensions of existing pensioners and former DNB employees are indexed only if the pension fund’s financial position so permits. Due to a funding deficit having arisen at the DNB Pension Fund, the Fund has drawn up a recovery plan. To make up for the deficit, a premium policy has been drawn up under which the Fund will restore its assets to the minimum funding level within a period of five years, as from end-2008 and the required level will be recovered within 15 years. On 31 December 2013, the funding ratio of the DNB Pension Fund based on the Ultimate Forward Rate, in line with DNB requirements, stood at 108.9%, so that a state of underfunding did not exist on
that date. Since the pension contributions paid are included as an expense, no provision has been created.

The contribution towards the health insurance premiums payable by pensioners is an allowance for a limited group of pensioners towards the costs concerned and may be characterised as a temporary transitional arrangement.

The service anniversary and retirement bonus arrangement provides for bonuses payable to staff upon 20, 30 and 40 years’ service and for bonuses payable to staff upon retirement and payments made to surviving dependants.

The liabilities and annual costs are actuarially determined. The assumptions used were:

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate for other staff remuneration (%)</td>
<td>anniversaries 2.8</td>
<td>anniversaries 2.8</td>
</tr>
<tr>
<td></td>
<td>Other 2.75</td>
<td>Other 2.4</td>
</tr>
<tr>
<td>General salary increase (%)</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Individual salary increase (average, %)</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Indexation (%)</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Mortality outlook</td>
<td>AG projection table</td>
<td>AG projection table</td>
</tr>
<tr>
<td></td>
<td>2012-62 acc. to mark-up on GBM/V life tables</td>
<td>2012-62 acc. to scheme-dependent mark-up on GBM/V life tables 2000-2005 (-1, -2)</td>
</tr>
<tr>
<td>Mortality trend, other staff remuneration (%)</td>
<td>anniversaries -3.5</td>
<td>health care cost scheme 13.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>miscellaneous 0.0</td>
</tr>
</tbody>
</table>
The changes in the provision for staff remuneration were as follows:

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Contribution to pensioners’ health care insurance premiums</th>
<th>Other</th>
<th>Rounding</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Position as at 31 December 2011</td>
<td>12</td>
<td>7</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>-1</td>
<td>-1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Release</td>
<td>-2</td>
<td>-2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Addition</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Position as at 31 December 2012</td>
<td>11</td>
<td>4</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>-1</td>
<td>-1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Release</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Addition</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>-1</td>
</tr>
<tr>
<td><strong>Position as at 31 December 2013</strong></td>
<td><strong>12</strong></td>
<td><strong>4</strong></td>
<td><strong>9</strong></td>
<td><strong>-1</strong></td>
</tr>
</tbody>
</table>

- Other provisions
These provisions relate to past reorganisations. A total of EUR 2 million of ‘Other provisions’ has a maturity of less than 1 year, while EUR 1 million has a maturity of between 1 and 5 years.

11. Revaluation accounts
The revaluation accounts break down as follows:

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Gold</th>
<th>Foreign currency</th>
<th>Securities and other financial instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Position as at 31 December 2011</td>
<td>23,413</td>
<td>22,834</td>
<td>90</td>
<td>489</td>
</tr>
<tr>
<td>Net revaluation change</td>
<td>871</td>
<td>873</td>
<td>-20</td>
<td>18</td>
</tr>
<tr>
<td>Position as at 31 December 2012</td>
<td>24,284</td>
<td>23,707</td>
<td>70</td>
<td>507</td>
</tr>
<tr>
<td>Net revaluation change</td>
<td>-7,438</td>
<td>-7,678</td>
<td>-45</td>
<td>285</td>
</tr>
<tr>
<td><strong>Position as at 31 December 2013</strong></td>
<td><strong>16,846</strong></td>
<td><strong>16,029</strong></td>
<td><strong>25</strong></td>
<td><strong>792</strong></td>
</tr>
</tbody>
</table>

The net decrease in the total revaluation accounts is mainly attributable to the decrease in the price of gold in 2013.
12. **Capital and reserves**

DNB’s authorised capital, which is fully issued and paid-up, amounts to EUR 500 million and is divided into 500 shares of EUR 1 million each. All shares are held by the central government. The statutory reserve comprises the book value of the intangible assets.

Capital and reserves before allocation of profits developed as follows:

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Capital</th>
<th>General reserve</th>
<th>Statutory reserve</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td><strong>Position as at 31 December 2011</strong></td>
<td><strong>7,244</strong></td>
<td>500</td>
<td><strong>6,735</strong></td>
<td><strong>9</strong></td>
</tr>
<tr>
<td>Transfer of 2011 net profit *</td>
<td><strong>463</strong></td>
<td></td>
<td><strong>463</strong></td>
<td></td>
</tr>
<tr>
<td>Change in statutory reserve</td>
<td></td>
<td></td>
<td><strong>-6</strong></td>
<td><strong>6</strong></td>
</tr>
<tr>
<td><strong>Position as at 31 December 2012</strong></td>
<td><strong>7,707</strong></td>
<td>500</td>
<td><strong>7,192</strong></td>
<td><strong>15</strong></td>
</tr>
<tr>
<td>Transfer of 2012 net profit</td>
<td><strong>104</strong></td>
<td></td>
<td><strong>104</strong></td>
<td></td>
</tr>
<tr>
<td>Change in statutory reserve</td>
<td></td>
<td></td>
<td><strong>-9</strong></td>
<td><strong>9</strong></td>
</tr>
<tr>
<td><strong>Position as at 31 December 2013</strong></td>
<td><strong>7,811</strong></td>
<td>500</td>
<td><strong>7,287</strong></td>
<td><strong>24</strong></td>
</tr>
</tbody>
</table>

* Net profit transfer concerns profit after dividend payment.

13. **Profit for the year**

As at year-end 2013, this item totalled EUR 1,178 million (year-end 2012: EUR 2,079 million).
Miscellaneous notes

Balance sheet amounts in foreign currency
DNB has fully hedged the exchange rate risk of its USD and AUD positions under asset items 2.2 'Balances with banks and security investments, external loans and other external assets' and 3 'Claims on euro area residents denominated in foreign currency' and that of the SDR position included in asset item 2.1 'Receivables from the International Monetary Fund (IMF)' and liability item 7 'Counterpart of special drawing rights allocated by the IMF', except for working stocks.

The euro equivalent of the sum total of assets denominated in foreign currency (included in asset items 2, 3 and 9.3) was EUR 16,921 million at year-end 2013 (year-end 2012: EUR 17,255 million). As at year-end 2013, the euro equivalent of the sum total of liabilities denominated in foreign currency (included in liability items 5, 6 and 7) was EUR 5,724 million (year-end 2012: EUR 5,638 million). The off-balance sheet position for foreign currencies is shown below.

Off-balance sheet positions relating to currency swaps, currency forwards and interest rate swaps.

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total EUR USD JPY GBP AUD XDR</td>
<td>Total EUR USD JPY GBP AUD XDR</td>
</tr>
<tr>
<td><strong>Currency swaps</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>11,214 10,782 432 0 0 0 0</td>
<td>11,775 11,292 483 0 0 0 0</td>
</tr>
<tr>
<td>Payables</td>
<td>-10,924 0 -6,834 -416 -13 -949 -2,712</td>
<td>-11,421 0 -6,794 -459 -14 -1,007 -3,147</td>
</tr>
<tr>
<td></td>
<td>290 10,782 -6,402 -416 -13 -949 -2,712</td>
<td>354 11,292 -6,311 -459 -14 -1,007 -3,147</td>
</tr>
<tr>
<td><strong>Currency forwards</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>929 473 456 0 0 0 0</td>
<td>689 341 348 0 0 0 0</td>
</tr>
<tr>
<td>Payables</td>
<td>-927 -469 -458 0 0 0 0</td>
<td>-687 -341 -346 0 0 0 0</td>
</tr>
<tr>
<td></td>
<td>2 4 -2 0 0 0 0</td>
<td>2 0 2 0 0 0 0</td>
</tr>
<tr>
<td><strong>Interest rate swaps</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0 0 0 0 0 0 0</td>
<td>0 0 0 0 0 0 0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>292 10,786 -6,404 -416 -13 -949 -2,712</td>
<td>356 11,292 -6,309 -459 -14 -1,007 -3,147</td>
</tr>
</tbody>
</table>

These instruments are used to hedge currency exposures. The total of EUR 292 million equals the net currency revaluation for these instruments, accounted for in the balance sheet, item 9.4 ‘Off-balance sheet instruments revaluation differences’.

Currency swaps
A currency swap is a transaction in which parties agree to directly buy or sell one currency in exchange for another currency at the spot or current rate and later to sell or buy back the currency at the forward rate. The spot purchase or sale is shown in the balance sheet, while the forward sale or purchase is recorded as an off-balance sheet item at the forward rate.

Currency forwards
A currency forward contract is a transaction in which parties agree to buy or sell a currency in return for another currency at a specific rate and for delivery
Financial statements

at a date in the future. The off-balance sheet positions are shown at the forward rate. Differences between the spot and forward rates for currency swaps and forward contracts are amortised and taken to the Profit and Loss Account. Unamortised forward returns are included in the balance sheet under ‘Accruals and prepaid expenses’ (9.5). Theses currency positions are included in the revaluation accounts on the balance sheet.

**Interest rate swaps**
The underlying value of interest rate swaps is also shown as an off-balance sheet item. The purpose of an interest rate swap is to hedge interest rate risk. An interest rate swap is an agreement to exchange interest cash flows during a predetermined period. The interest amounts are calculated on the underlying value of the interest rate swap. Only the interest flows are actually exchanged. The interest rate swaps are revalued at market value. Negative unrealised revaluations are offset against the result on the year. Unrealised revaluation gains are added to the ‘Revaluation accounts’. Unrealised losses are amortised over the residual maturity of the contract.

The underlying values with regard to interest rate swaps were as follows

<table>
<thead>
<tr>
<th></th>
<th>31 December 2013</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Euro portfolio</td>
<td>205</td>
<td>224</td>
</tr>
<tr>
<td>US dollar portfolio</td>
<td>0</td>
<td>227</td>
</tr>
<tr>
<td>Other Financial Assets (OFA)</td>
<td>0</td>
<td>192</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>205</strong></td>
<td><strong>643</strong></td>
</tr>
</tbody>
</table>

**Custody**
DNB holds securities and other documents of value in custody for third parties. Such custody is for the account and risk of the depositors.

**Guarantee scheme for crisis-related assets**
In 2013 the financial risks for DNB decreased as a result of the measures taken by the Eurosystem to stabilise the operation of the euro area. Whereas the risk profile of DNB’s financial exposures improved in 2013, it remains relatively high. The financial risk (excluding gold) at year-end 2013 was determined at EUR 11.2 billion. DNB uses the expected shortfall (ES) method to measure and manage its financial risks, with various scenarios being calculated. The resulting calculated risk is higher than the total capital and general reserve of EUR 7.8 billion. In March 2013, given the risks arising from the debt crisis, the Minister of Finance issued a free and unconditional guarantee of up to EUR 5.7 billion on the basis of the scenario risks. This guarantee relates to DNB’s share in possible losses on crisis-related exposures in the monetary portfolios.

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12 More information on DNB’s financial risks can be found in Section 5.6 of the Annual Report.
Off-balance sheet liabilities

Liability claims and procedures
By reason of its supervisory task or otherwise, DNB may receive liability notices or pre-announcements of such notices. In some cases liability proceedings have been brought against DNB. Where the liability amounts cannot reasonably be predicted or where reasonable doubts remain as to whether a claim will stand up, DNB suffices by mentioning such cases in these Notes. The Governing Board saw no reason to make a provision on this account in 2013. The relevant current cases are discussed in more detail below.

Claims of Fortis shareholders
A group of Belgian Fortis shareholders has brought proceedings against DNB – as well as against the Dutch State and Fortis – before the Brussels Commercial Court in an action including a claim for damages of EUR 5 per share. It is not known how many shares are involved. In its ruling of 8 December 2009, the Commercial Court honoured the Dutch State’s and DNB’s invocation of immunity in these proceedings. Some of the Fortis shareholders appealed against this ruling in 2011. In 2013, the Appeal Court ruled that the Dutch State and DNB cannot be tried before a Belgian court on the grounds of immunity.

Stichting Pensioenfonds Vereenigde Glasfabrieken
The Appeals Board for Trade and Industry, in its ruling of 10 September 2013, rejected the appeal by DNB and upheld the initial Court ruling. The case concerned DNB’s decision to instruct a pension fund (Stichting Pensioenfonds Vereenigde Glasfabrieken) to substantially reduce its investments in gold. On 15 March 2012 the District Court ruled against DNB, reversed the decision on objection, revoked DNB’s principal decision and reopened the investigation in preparation for a further ruling on the amount of compensation payable. The latter proceedings have been resumed. In May 2012, the pension fund calculated its loss at approximately EUR 9.5 million. The Amsterdam District Court is expected to rule on the claim for damages in 2014.

Stichting Gedupeerden Easy Life
A foundation (Stichting Gedupeerden Easy Life) set up to represent investors claiming to have lost money as a result of the activities of Easy Life initiated legal proceedings against DNB at the Amsterdam District Court in 2012. The foundation’s claims include a request for the Court to rule that DNB acted unlawfully towards investors who invested in various companies (not subject to supervision) that operated under the Easy Life banner and to order DNB to compensate the losses the investors suffered. The Court reviewed the submissions on both sides and in early December 2013 heard the parties in session. A ruling is expected in the first half of 2014.

Shipping company and entrepreneur from Greece
A natural person and an enterprise in Greece have instigated legal proceedings in Greece against parties including DNB and the Dutch State. The dispute leading to the summons concerned a commercial dispute between the company and a banking consortium on repayment of a credit facility and the related call on a bank guarantee. The main complaint against DNB would seem to be that DNB failed to intervene adequately after allegedly being informed about the laundering of proceeds from criminal activities. In March 2013, DNB submitted a notice of defence to the law court in Greece. The hearing of the case has been postponed until April 2014.
Receivers in the bankruptcy of DSB Bank and several interest groups
In November 2013, the receivers in the bankruptcy of DSB Bank and several interest groups of accountholders at DSB Bank summoned DNB before the Amsterdam District Court. The claimants asked the Court to conclude that DNB had acted unlawfully and is therefore liable to pay damages arising from the bankruptcy of DSB Bank. The allegations brought against DNB include the following: (i) DNB wrongfully issued a banking authorisation and Declarations of No-Objection to DSB Bank in 2005; (ii) DNB acted with insufficient authority in exercising ongoing supervision of DSB; (iii) DNB acted wrongfully in writing down collateral assets pledged by DSB in the context of ECB facilities, thereby acting negligently; and (iv) DNB acted negligently by showing insufficient commitment to the interests of potential creditors of DSB.
Notes to the Profit and Loss Account

Operating income

1 and 2 Net interest income
This item includes interest income and interest expense in respect of the assets and liabilities denominated in euro.

Interest income breaks down as follows:

Millions

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Investments</td>
<td>229</td>
<td>398</td>
</tr>
<tr>
<td>Money market lending</td>
<td>79</td>
<td>184</td>
</tr>
<tr>
<td>Monetary portfolios</td>
<td>714</td>
<td>769</td>
</tr>
<tr>
<td>Eurosistem claims/liabilities</td>
<td>716</td>
<td>1,582</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,738</strong></td>
<td><strong>2,933</strong></td>
</tr>
</tbody>
</table>

Interest expenses break down as follows:

Millions

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Money market liabilities</td>
<td>-99</td>
<td>-358</td>
</tr>
<tr>
<td>Other</td>
<td>-1</td>
<td>-19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-100</strong></td>
<td><strong>-377</strong></td>
</tr>
</tbody>
</table>

Interest income and expenses both declined due to a decrease of average claims and liabilities, as Dutch banks effected early redemption of three-year refinancing loans and drew down their surplus liquidity holdings. Interest income and expenses also declined due to low average interest rate levels.

3. Realised gains/losses arising from financial operations

Millions

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Exchange rate gains/losses</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>Price gains/losses on sales of fixed-income securities</td>
<td>47</td>
<td>312</td>
</tr>
<tr>
<td>Price gains/losses on sales of equities</td>
<td>62</td>
<td>21</td>
</tr>
<tr>
<td>Gains/losses on sales of gold</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>120</strong></td>
<td><strong>337</strong></td>
</tr>
</tbody>
</table>
A decline in the price gains on fixed-income instruments was caused by a drop in sales and by duration reduction with a view to reduce risks. The fall in the price gains on sales of equities resulted from lower sales in 2013.

4. Write-downs to lower market value
The write-downs consist largely of price revaluation losses on fixed-income securities (EUR 30 million).

7. Income from equity shares and participating interests
This item amounted to EUR 126 million at year-end 2013 and included the results of DNB’s participating interest in the ECB (EUR 102 million) and dividends from equity index investments (EUR 17 million). This item amounted to EUR 61 million at year-end 2012, consisting mostly of the participating interest in the ECB (EUR 37 million).

8. Net result of monetary income pooling
This item represents the outcome of the pooling and reallocation of monetary income during 2013. The resulting EUR 484 million expense was lower than the EUR 945 million expense incurred in 2012. This item also includes DNB’s share in the net result of a EUR 17 million provision against risks of default by counterparties within the Eurosystem (2012: EUR 36 million).

The amount of each Eurosystem NCB’s monetary income is determined by measuring the actual annual income that derives from the earmarked assets held against its liability base. The earmarkable assets consist of the following items: ‘Lending to euro area credit institutions related to monetary policy operations denominated in euro’, ‘Securities held for monetary policy purposes’, ‘Claims equivalent to the transfer of foreign reserves to the ECB’ ‘Other claims within the Eurosystem (net) resulting from TARGET2 transactions’. ‘Net claims related to the allocation of banknotes within the Eurosystem’ and a limited amount of gold reserves proportional to the Eurosystem capital key. Gold is assumed to generate no income. Securities held for monetary policy purposes under the Decision ECB/2009/16 of 2 July 2009 on the implementation of the covered bond purchase programme or the Decision ECB/2001/17 of 3 November 2011 on the implementation of the covered bonds purchase programme (CBPP 1 and CBPP 2) are assumed to generate income at the refinancing rate. Where the value of an NCB’s earmarked assets exceeds or falls short of the value of its liability base, the difference is offset by applying the refinancing percentage to the value of the difference. The income on the earmarked assets is included under ‘Interest income’.

The liability base consists of the following items: ‘Banknotes in circulation’, ‘Liabilities to euro area credit institutions related to monetary policy operations denominated in euro’, ‘Other liabilities within the Eurosystem (net) resulting from TARGET2 transactions’, and ‘Net liabilities related to the allocation of euro banknotes within the Eurosystem’. Any interest paid on items included in the liability base has to be deducted from the monetary income to be pooled.
The net result of pooling monetary income can be broken down as follows:

<table>
<thead>
<tr>
<th>Millions</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Monetary income accruing to DNB</td>
<td>951</td>
<td>1,335</td>
</tr>
<tr>
<td>Monetary income earned by DNB</td>
<td>-1,436</td>
<td>-2,283</td>
</tr>
<tr>
<td>Net monetary income</td>
<td>-485</td>
<td>-948</td>
</tr>
<tr>
<td>Adjustment of monetary income pooling</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Net result of monetary income pooling</td>
<td>-484</td>
<td>-945</td>
</tr>
<tr>
<td>Share of DNB in release of ‘Provision for monetary policy operations’</td>
<td>17</td>
<td>36</td>
</tr>
<tr>
<td><strong>Overall net result of monetary income pooling</strong></td>
<td><strong>-467</strong></td>
<td><strong>-909</strong></td>
</tr>
</tbody>
</table>

The monetary income pooled by the Eurosystem NCBs is to be allocated among the NCBs in proportion to the subscribed capital key. Monetary income pooling and redistribution leads to redistribution effects. Such effects may arise from, on the one hand, differences between Eurosystem NCBs with respect to returns on certain earmarked assets or interest paid on related liabilities. On the other hand, the shares of earmarkable assets and related liabilities of those national banks differ from the shares in the total earmarked assets and related liabilities allocated to the NCBs according to the Eurosystem capital key. For DNB, the net result of the pooling of monetary income (EUR -467 million, compared to EUR -909 million at year-end 2012) arises from the difference between the monetary income pooled by DNB (EUR 1,436 million), and the monetary income accruing to DNB according to the Eurosystem capital key (EUR 951 million). In addition, in 2013 corrections have been made to the redistribution of monetary income in 2008 and 2012, leading to an EUR 1 million net gain for DNB. Furthermore, it includes DNB’s share in the net result of the change in the ‘Provision for monetary policy operations’, being a release to profit of EUR 17 million against a release of EUR 36 million in 2012.

9. Other income
This item includes the proceeds arising from the fact that the costs of supervision are passed on to the supervised institutions, as well as the government contribution to the performance of supervisory activities. In 2012, the increase in other income was attributable to the release of EUR 243 million from for guilder banknotes.

<table>
<thead>
<tr>
<th>Millions</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Contribution of supervised institutions</td>
<td>120</td>
<td>97</td>
</tr>
<tr>
<td>Government contribution</td>
<td>21</td>
<td>31</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
<td>257</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>145</strong></td>
<td><strong>385</strong></td>
</tr>
</tbody>
</table>
### Operating expenses

The operating expenses break down as follows:

**Millions**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Staff costs</td>
<td>-203</td>
<td>-194</td>
</tr>
<tr>
<td>Other administrative expenses</td>
<td>-84</td>
<td>-79</td>
</tr>
<tr>
<td>Depreciation of (intangible fixed assets</td>
<td>-32</td>
<td>-27</td>
</tr>
<tr>
<td>Costs of production of banknotes</td>
<td>-37</td>
<td>-14</td>
</tr>
<tr>
<td>Other expenses</td>
<td>-1</td>
<td>-1</td>
</tr>
<tr>
<td>Capitalised costs of software</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td><strong>-349</strong></td>
<td><strong>-311</strong></td>
</tr>
</tbody>
</table>

### 10. Staff costs

The average number of employees, expressed as full-time equivalents (FTEs), came to 1,659 in 2013, compared to 1,625 in 2012. The increase is mainly attributable to increases in the supervision divisions.

Total staff costs in 2013 and 2012 break down as follows:

**Millions**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>-132</td>
<td>-126</td>
</tr>
<tr>
<td>Social security contributions</td>
<td>-15</td>
<td>-12</td>
</tr>
<tr>
<td>Pension burden</td>
<td>-38</td>
<td>-40</td>
</tr>
<tr>
<td>Other staff costs</td>
<td>-18</td>
<td>-16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-203</strong></td>
<td><strong>-194</strong></td>
</tr>
</tbody>
</table>

The annual costs (EUR 38 million) relating to the pension scheme are included under ‘Pension burden’. It equals contributions made (EUR 43 million) less an employer-paid contribution (EUR 5 million).

The annual costs on account of the ‘Contribution to the health care insurance premiums of pensioners’ are included under ‘Social insurance contributions’. The annual costs on account of other staff remuneration are included under ‘Wages and salaries’ and ‘Social insurance contributions’.
Remuneration

General observations
As of the reporting year 2013, under the Act on the Standardisation of the Remuneration of Senior Executives in the Public and Semi-Public Sector (Wet normering bezoldiging topfunctionarissen publieke en semipublieke sector – WNT), DNB is required to disclose, apart from the remuneration of Governing Board and Supervisory Board members under Title 9, Volume 2 of the Dutch Civil Code (BW2), the remuneration of non-executive staff exceeding the WNT maximum. DNB is currently operating under the transitional arrangement included in the WNT. In recruiting the right people to perform its statutory duties, DNB has to compete in the relevant segment of the labour market. Unless stated otherwise, all officials mentioned worked in full employment throughout the year.

Governing Board
The annual salaries of the Governing Board members in 2013, as fixed by the Minister of Finance, include holiday allowance and an extra month’s pay. The pension scheme for the members of the Governing Board is in accordance with the agreements made with the Minister of Finance in 2005. Like other staff, the members of the Governing Board contribute to their pension premiums.

The amounts paid in 2013 and 2012 to or on behalf of each member of the Governing Board – salaries, employer’s social insurance contributions, other payments and pension contributions – were as follows:

<table>
<thead>
<tr>
<th>Disclosure under:</th>
<th>BW2 + WNT</th>
<th>BW2/WNT</th>
<th>BW2</th>
<th>BW2 + WNT</th>
<th>WNT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Salary</td>
<td>Employer’s contributions and other compensation*</td>
<td>Employer’s contribution to one-off crisis levy**</td>
<td>Pension burden</td>
<td>Taxable variable costs compensation</td>
</tr>
<tr>
<td>K.H.W. Knot</td>
<td>EUR 324,402</td>
<td>EUR 320,513</td>
<td>EUR 17,330</td>
<td>EUR 18,111</td>
<td>EUR 27,916</td>
</tr>
<tr>
<td>A.J. Kellermann</td>
<td>EUR 293,507</td>
<td>EUR 289,988</td>
<td>EUR 15,920</td>
<td>EUR 17,218</td>
<td>EUR 22,343</td>
</tr>
<tr>
<td>F. Elderson</td>
<td>EUR 275,226</td>
<td>EUR 271,926</td>
<td>EUR 15,920</td>
<td>EUR 23,902</td>
<td>EUR 19,542</td>
</tr>
<tr>
<td>J. Swank</td>
<td>EUR 275,226</td>
<td>EUR 271,926</td>
<td>EUR 16,214</td>
<td>EUR 16,028</td>
<td>EUR 17,549</td>
</tr>
<tr>
<td>Total</td>
<td>EUR 1,467,521</td>
<td>EUR 1,446,970</td>
<td>EUR 85,707</td>
<td>EUR 91,543</td>
<td>EUR 111,465</td>
</tr>
</tbody>
</table>

* Employer’s contributions disclosed under BW2. In each case, the maximum employer’s contribution for 2013 of EUR 8,477 applies. Other compensation items are disclosed under BW2 and WNT.
** Employers are charged a one-off 10% ‘crisis levy’ on the amount by which any salary exceeds EUR 150,000 in the financial year. The levy is payable in toto during the year following the financial year in which the salary was paid.
Financial statements

The table below presents the mortgage loans extended to Governing Board members under DNB’s staff mortgage loan scheme.

<table>
<thead>
<tr>
<th>Principal outstanding</th>
<th>31 December 2013</th>
<th>EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>F. Elderson</td>
<td>337,361</td>
<td></td>
</tr>
<tr>
<td>K.H.W. Knot</td>
<td>1,200,000</td>
<td></td>
</tr>
<tr>
<td>J. Swank</td>
<td>444,705</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,982,066</strong></td>
<td></td>
</tr>
</tbody>
</table>

Remuneration of the Supervisory Board

The basic fee for a member of the Supervisory Board is EUR 25,372.56 on an annual basis. The Chairman of the Supervisory Board receives EUR 31,571.28. Members of the Supervisory Board who also sit on a Committee receive an additional fee of EUR 6,343.20. These compensations are proportional to the terms of office. The fees for Supervisory Board members are adjusted annually according to the index for consumer prices published by Statistics Netherlands. The total fees (excluding VAT) paid to the members of the Supervisory Board for the year 2013 amounted to EUR 272,613 (2012: EUR 254,101).

<table>
<thead>
<tr>
<th>Name</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.H.G. Rinnooy Kan (Chairman)</td>
<td>44,258</td>
<td>21,589</td>
</tr>
<tr>
<td>A.M. Fentener van Vlissingen (Vice-Chairman)</td>
<td>31,716</td>
<td>30,942</td>
</tr>
<tr>
<td>A.H. van Delden**</td>
<td>31,716</td>
<td>29,911</td>
</tr>
<tr>
<td>K.P. Goudswaard</td>
<td>38,059</td>
<td>7,220</td>
</tr>
<tr>
<td>W.J. Kuijken**</td>
<td>31,716</td>
<td>20,628</td>
</tr>
<tr>
<td>J.A. van Manen</td>
<td>31,716</td>
<td>29,911</td>
</tr>
<tr>
<td>F. Sijbesma</td>
<td>31,716</td>
<td>10,314</td>
</tr>
<tr>
<td>H.M. Vletter-van Dort</td>
<td>31,716</td>
<td>29,911</td>
</tr>
<tr>
<td>J.F. van Duyne (Chairman)</td>
<td>-</td>
<td>18,495</td>
</tr>
<tr>
<td>E. Kist (Vice-Chairman)</td>
<td>-</td>
<td>20,628</td>
</tr>
</tbody>
</table>
| A.H.M. de Jong**            | -      | 6,188  *
| G.J. Kleisterlee            | -      | 2,579  |
| W.G. Tuinenburg             | -      | 25,785 |
| **Total**                   | **272,613** | **254,101** |

These amounts are disclosed under BW2 and WNT.

* Fee paid to the employer.

** Also sits on the Bank Council. This carries a compensation of EUR 3,140 on an annual basis (2012: EUR 2,850). This amount is not included here.
Posts fulfilled under an employment contract (whose remuneration exceeds the EUR 228,599 WNT norm):

<table>
<thead>
<tr>
<th></th>
<th>Remuneration</th>
<th>Taxable fixed and variable expenses</th>
<th>Deferred remuneration*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Division Director</td>
<td>220,641</td>
<td>2,400</td>
<td>58,823</td>
</tr>
<tr>
<td>Supervisory Officer</td>
<td>214,421</td>
<td>7,089</td>
<td>38,313</td>
</tr>
<tr>
<td>Division Director</td>
<td>202,947</td>
<td>2,400</td>
<td>54,488</td>
</tr>
<tr>
<td>Division Director</td>
<td>202,629</td>
<td>2,582</td>
<td>54,464</td>
</tr>
<tr>
<td>Division Director</td>
<td>202,592</td>
<td>2,400</td>
<td>53,971</td>
</tr>
<tr>
<td>Division Director</td>
<td>199,710</td>
<td>2,925</td>
<td>54,937</td>
</tr>
<tr>
<td>Division Director</td>
<td>186,721</td>
<td>2,482</td>
<td>54,488</td>
</tr>
<tr>
<td>Division Director</td>
<td>186,461</td>
<td>2,400</td>
<td>48,155</td>
</tr>
<tr>
<td>Division Director</td>
<td>183,816</td>
<td>2,400</td>
<td>53,814</td>
</tr>
<tr>
<td>Division Director</td>
<td>178,821</td>
<td>2,430</td>
<td>51,285</td>
</tr>
<tr>
<td>Division Director</td>
<td>174,023</td>
<td>2,400</td>
<td>46,213</td>
</tr>
<tr>
<td>Division Director**</td>
<td>167,366</td>
<td>4,483</td>
<td>47,047</td>
</tr>
<tr>
<td>Division Director***</td>
<td>87,732</td>
<td>200</td>
<td>16,890</td>
</tr>
</tbody>
</table>

* Employer’s pension contribution.
** WNT norm in proportion to average number of contract hours: EUR 216,471.
*** Left employment with DNB on 1 February 2013. This amount includes, apart from salary, departure-related sale of remaining holiday hours, holiday bonus etc.

With one exception, all these officials hold employment contracts based on 38.5-hour working weeks. In recruiting the right people to perform its statutory duties, DNB has to compete in the relevant segment of the labour market. These officials exceed the WNT norm in accordance with the collective labour agreement of DNB. One supervisory officer has been included because the conversion of a large number of saved-up holiday hours in 2013 caused this individual to exceed the WNT norm.

11. Other administrative expenses
Total other administrative expenses can be specified as follows:

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR</td>
<td>EUR</td>
</tr>
<tr>
<td>Temporary staff and outsourcing</td>
<td>-33</td>
<td>-30</td>
</tr>
<tr>
<td>Travel and accommodation expenses</td>
<td>-5</td>
<td>-4</td>
</tr>
<tr>
<td>Accommodation</td>
<td>-8</td>
<td>-10</td>
</tr>
<tr>
<td>Office equipment, software and office expenses</td>
<td>-25</td>
<td>-22</td>
</tr>
<tr>
<td>General expenses</td>
<td>-13</td>
<td>-13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-84</strong></td>
<td><strong>-79</strong></td>
</tr>
</tbody>
</table>
The General expenses include the fee paid to the external auditor. This fee breaks down as follows:

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit of the financial statements</td>
<td>289,468</td>
<td>284,762</td>
</tr>
<tr>
<td>Other audit engagements</td>
<td>89,407</td>
<td>114,094</td>
</tr>
<tr>
<td>Tax consultancy services</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other non-audit services</td>
<td>10,164</td>
<td>57,861</td>
</tr>
<tr>
<td>Total</td>
<td>389,039</td>
<td>456,717</td>
</tr>
</tbody>
</table>
Costs of DNB’s public service duties

In its capacity as an independent public body (ZBO), DNB exercises prudential supervision over financial institutions. In accordance with supervision legislation, more detailed information is given in a separate report. The actual costs as accounted for in the ZBO report were as follows:

<table>
<thead>
<tr>
<th></th>
<th>Realisation 2013</th>
<th>Budget 2013</th>
<th>Realisation 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks *</td>
<td>62</td>
<td>61</td>
<td>51</td>
</tr>
<tr>
<td>Pension funds</td>
<td>27</td>
<td>32</td>
<td>29</td>
</tr>
<tr>
<td>Insurers **</td>
<td>38</td>
<td>42</td>
<td>35</td>
</tr>
<tr>
<td>Other institutions and Sanctions Act</td>
<td>13</td>
<td>14</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total costs of supervision</strong></td>
<td>140</td>
<td>149</td>
<td>127</td>
</tr>
<tr>
<td>FEC unit ***</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>141</td>
<td>150</td>
<td>128</td>
</tr>
</tbody>
</table>

* Banks including other (non-bank) credit institutions
** Including the costs for health care insurers totalling EUR 5.5 million (budgeted: EUR 6 million).
*** Under the new Financial Supervision Funding Act (Wet bekostiging financieel toezicht), expenses on behalf of the FEC unit are no longer included in the costs of supervision. The comparative figures have been restated accordingly.

For detailed notes, the reader is referred to DNB’s (Dutch-language) account of its public tasks in 2013.
4. Other information

Independent auditor’s report

To the Governing Board, the Supervisory Board and the General Meeting of Shareholders of De Nederlandsche Bank NV

Report on the financial statements

We have audited the accompanying financial statements of De Nederlandsche Bank NV, Amsterdam, for the year ended 31 December 2013 as set out on pages 143 to 182. The financial statements comprise the balance sheet as at 31 December 2013, the profit and loss account for the year then ended and the notes, comprising a summary of the accounting policies and other explanatory information.

Governing Board’s responsibility

The Governing Board of De Nederlandsche Bank NV is responsible for the preparation of the financial statements in accordance with accounting principles as set out in Guideline ECB/2010/20, supplemented by the applicable requirements of Title 9, Volume 2 of the Dutch Civil Code pursuant to Section 17 of the Bank Act 1998, and for the preparation of the Annual Report as set out on pages 5 to 141 in accordance with Title 9, Volume 2 of the Dutch Civil Code. The Governing Board is also responsible for such internal control as it considers necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. This requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Governing Board, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.
Opinion with respect to the financial statements

In our opinion, the 2013 financial statements of De Nederlandsche Bank NV have been compiled, in all material respects, in accordance with the accounting principles as set out in Guideline ECB/2010/20, supplemented by the applicable requirements of Title 9, Volume 2 of the Dutch Civil Code pursuant to Section 17 of the Bank Act 1998.

Report on other legal and regulatory requirements

Pursuant to the legal requirement under Section 2:393 (5) under e and f of the Dutch Civil Code, we have no deficiencies to report as a result of our examination whether the Annual Report as set out on pages 5 to 141, to the extent we can assess, has been prepared in accordance with Title 9, Volume 2 of this Code, and the information as required under Section 2:392 (1) under b-h, annexed on page 185.

In addition, we report that the Annual Report as set out on pages 5 to 141, to the extent we can assess, is consistent with the financial statements as required by Section 2:391 (4) of the Dutch Civil Code.

Amsterdam, 12 March 2014

Deloitte Accountants B.V.

H.H.H. Wieleman
Financial statements

Provisions governing the appropriation of profit
These provisions are set out in article 22(2) of the Articles of Association of De Nederlandsche Bank NV and read as follows:

The profit, as shown in the adopted Financial Statements, shall be at the disposal of the general meeting of shareholders.

Appropriation of profit
With due observance of the above provisions of the Articles of Association, the appropriation of profit is as follows:

<table>
<thead>
<tr>
<th>Appropriation of profit</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer to general reserve</td>
<td>59</td>
<td>104</td>
</tr>
<tr>
<td>Distribution to the State</td>
<td>1,119</td>
<td>1,975</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>1,178</td>
<td>2,079</td>
</tr>
</tbody>
</table>

Events after balance sheet date
No events after the balance sheet date had material impact on the 2013 financial data.