History of DNB

Introduction

In less than two hundred years, the Nederlandsche Bank (DNB) has evolved from a private provider of credit to an integral part of the Eurosystem. The centre of gravity moved from Amsterdam to Frankfurt, the guilder disappeared and the euro took its place. But unchanging throughout its history, DNB has fulfilled its role as the 'guardian of financial stability'.

The early years of DNB were difficult: Although DNB was the official circulation bank of the Netherlands, its banknotes were very slow in gaining currency. Not until 1850 did DNB develop into a fully fledged national bank, extending its activities throughout the country.

During the first half of the 20th century DNB proved itself by preserving the Netherlands from several financial crises. From that time onwards, once the golden standard had been relinquished in 1936, DNB gained prominence as a monetary institution. And after the Second World War, this role was enshrined in the 1948 Bank Act, which stated that DNB was to bear (joint) responsibility for the stability of the value of money: of the guilder and, later, the euro.

In 1952, the role of DNB as the supervisor of the banking system was also formalised. Step by step, in the years that followed, this supervisory role was expanded to include all financial institutions. Financial supervision underwent a transformation in 2002, when DNB was given responsibility for prudential supervision of financial institutions and the soundness of the financial system. At the same time 'market conduct supervision' was entrusted to the Netherlands Authority for the Financial Markets. In 2004, DNB merged with the pensions and insurance supervisor, called the Pensioen- en Verzekeringskamer.

Today, the Nederlandsche Bank is an emblem of financial stability that plays a prominent role both domestically and in the international arena.

Circulation bank (1814-1863)

In 1814 the Nederlandsche Bank was founded by King William I. It was one of his first official acts. The Netherlands was newly liberated from French domination, and Napoleon had been defeated. But the economy was in a bad way. There was little that recalled the golden age of the Republic of the Seven United Netherlands. Amsterdam's part as an international financial centre and trading hub had been played. Paragons of Dutch enterprise such as the Amsterdam Exchange Bank and the United East-India Company were moribund.

William wanted to find prosperity for his kingdom and work for his people, and for this he needed a national bank. He envisioned an institution that was able to reinvigorate the economy by extending credit and that created a universal medium of exchange through the issue of banknotes.

The guilder had been used as a means of payment in the Netherlands since the 14th century. From 1694, the guilder had, in fact, been the principal coin – albeit not the only one – in circulation. However, the Dutch Republic, existing of seven loosely connected and more or less independent provinces, had never succeeded in introducing a single currency. The French had, however, and William decided to follow in their tracks. Minted at Utrecht, the guilder was henceforth to be the single currency of the Netherlands. DNB was to defend the coin from Amsterdam, in its paper form.

King William enshrined the duties of DNB in a Charter, which stated that DNB was the only bank in the Netherlands allowed both to issue banknotes and to extend credit. Also prescribed by the Charter was DNB's legal form as a 'company without firm', a precursor of the present-day public limited company. Its shares were owned by its financiers.

With its monopoly on the issue of banknotes, DNB became the circulation bank for the Netherlands – although the issue was limited to a maximum. From 1863, this maximum was calculated according to the proportional cover principle: 40 per cent of the banknote circulation had to be covered by the metal stock, the gold and silver stored in the vaults of DNB. Extending credit was the other duty imposed on DNB. This it did by discounting letters of exchange and by lending against securities and goods. DNB also acted as the State's cashier, which meant that all the State's revenues and expenses rand through the books of DNB.

DNB had a difficult start in life. As a newcomer it was greeted by distrust. Established trading houses and bankers feared its competition, with the banknotes arousing particular suspicion. For decades people continued to prefer solid cash. Thus DNB's influence and reach was insignificant and for a long time remained limited to Amsterdam.

National bank (1863-1914)

During the second half of the 19th century, DNB developed into the kind of national bank William I had envisioned. This was largely owing to the economic upswing in the Netherlands, which encouraged the demand for credit, and also to the introduction of the 1863 Bank Act.

DNB took up a strong position as a lender. It could do so because of its large stock of metal allowing it to meet the growing demand for credit. Other financiers, such as cashiers and bankers, were reined in by their more limited resources. Moreover DNB had been given, in the Bank Act of 1863, the mandate to spread its wings in a geographical sense, and it soon opened branches throughout the countries. Thus DNB was able to fill regional needs for cash and credit as well, contributing to broad industrial growth.

With the emergence of private banking during the final decades of the 19th century, the role of DNB began to change. Traditional clients, many of them corporate, shifted their custom to private banks because there were able to offer a broader range of services. These included interest payments on deposits and current-account lending. Private banks, in turn, came to DNB to rediscount their clients' paper and to borrow on their securities portfolios, which considerably increased their own lending power. As a result DNB, from a lending bank for corporate clients gradually changed into a bankers' lender – a process that was completed during the 1920s.

Now that the emphasis had shifted towards lending to (private) banks, DNB had a vested interest in information on the reliability of its customers. It therefore imposed various rules on banks with respect to their outstanding loans and their capital. They also had to submit their monthly accounts to DNB. And thus, as if naturally, the role of the Nederlandsche Bank as a banking supervisor began to take shape. Because things in those days were done by mutual, informal agreement, DNB was said to exercise 'paternal supervision'.

Central Bank (1914-1945)

At the time the First World War broke out, DNB was coming into its own as a true central bank. In late July 1914 DNB prevented a run on the banks and thus preserved the Netherlands from an acute crisis. The banknote circulation continued almost without a hitch. Confidence in the guilder was unshaken, despite the temporary reduction of the statutory metal cover from 40% to 20%, which was, in fact, to last until 1929.

After those difficult war years, which despite its neutrality had not left the Netherlands unharmed, the economy picked up again. Flooded with corporate credit demand, the commercial banks thrived. Through mergers and takeovers five large banks had sprung up, each of which had a network of branches, and they dominated the lending market.

When in the late 1920s, the economic sky darkened again, it appeared that some banks had extended too much credit against too little collateral. Dozens of smaller banks ran into difficulties and had to be restructured or wound up. Some others collapsed. In one third of such cases DNB played an active part as the 'lender of last resort'. This could mean that DNB guaranteed the liabilities of banks in the process of being wound up, or that it offered emergency credit lines. In other cases DNB forced banks to reorganise. By such interventions DNB tried to stave off a domino effect, with the failure of one bank causing the failure of others, and thereby a financial crisis.

One of the consequences of the banking crisis during the 1920s was the creation in 1937 of a State Commission to study the desirability of statutory supervision of the private banking system. The work of the Commission was cut short by the outbreak of the Second World War.

The Nederlandsche Bank as a monetary institution (1945-1999)

The Bank Act of 1948 made it DNB responsibility to preserve the value of the currency. Form that time onwards, DNB called itself the 'Guardian of the guilder' – which in fact it had been since 1814. Even then, DNB had been the only institution empowered to issue banknotes and hence responsible for the public confidence in paper money.

During its first century, the central principle underlying DNB's monetary policy had been to maintain the statutory value of the guilder in silver and/or gold. Within the constraints of the double, the silver (1847-1875) or the golden (1874-1914 and 1925-1936) standards, DNB operated more or less independently. Precious metal had the double function of securing the domestic value of the guilder and of maintaining its external exchange rate.

In 1936 the Netherlands relinquished the golden standard. This meant the demise of the metallic monetary system. Banknotes henceforth were no longer exchangeable for gold and the acceptance of paper money became primarily a matter of trust. The relinquishment of the golden standard was to have far-reaching consequences. The government and DNB had to find another stable standard by which to stabilise the value of money. Like many other countries that suffered from the global pre-war depression, the Netherlands opted to influence the business cycle by co-ordinating its monetary policy with its social and economic policy. Thus, the gravitational centre of monetary policy was shifted towards the government.

When DNB was nationalised in 1948, the Bank Act was changed as well. It formulated DNB's main duty as follows: *'... to regulate the value of the Netherlands' currency in such a manner as will be most serviceable to the national wealth, while stabilising that value as much as possible'*. This wording made clear that monetary policy was not just the business of DNB but was part of general economic policy and as such lay most definitely within the competence of the government. In the last instance, the Minister of Finance had the final say and could, if necessary, give DNB directions '... serving the co-ordination of the government's monetary and financial policies and the policy of the Bank. The Bank act also made DNB responsible for the banknote circulation and gave it the duty to facilitate the non-cash payment system, to promote cross-border payments and finally to exercise supervision over credit institutions.

In the years after 1948, DNB grew into a modern monetary institution that played an important role in creating the Netherlands' unprecedented prosperity. In the meantime, European co-operation also got underway, leading ultimately to the establishment of Economic and Monetary Union (EMU) and, still later, the introduction of a common European currency, the euro.

With the introduction of the euro, monetary policy changed from a national affair to a matter for all euro countries. The year 1998 therefore saw the entry into force of a new Bank Act. In essence, the duties of DNB remained as before. But the relationship between the government and DNB changed. The Minister of Finance lost his right to give directions, in exchange for a right to *'data or information ... which he deems necessary for the determination of the government's financial and economic policies ...'*.

Under EMU, monetary policy for the entire euro area is determined by the European Central Bank (ECB) in Frankfurt. DNB has the duty to help shape this policy together with the ECB and the other national central banks of the euro area. The primary objective of euro area monetary policy is to maintain price stability. In addition, the ECB supports the general economic policies of the European Union which aims to promote 'sustainable, non-inflationary growth'. The ECB is independent from political processes.

Guardian of financial stability

With the entry into force of the Act on the Supervision of the Credit System ('the Act') in 1952, banking supervision was given a statutory basis. The Act refers to 'credit institutions', a collective term that includes general banks, banking co-operatives, savings banks and securities banks, as well as capital market institutions such as mortgage banks.

Initially, the Act distinguished between social and economic supervision and prudential supervision.

- social and economic supervision, also known as monetary supervision, empowered DNB to control lending by private banks. Through lending, banks create new money. This is fine, up to a point where monetary stability is in danger.
- prudential supervision aims to protect the interest of the public who entrust their money to banks in the form of savings, deposits and checking account balances.

The explosive development of the world's financial markets and their many offshoots has created a need for policies whose first aim is to guarantee the stability of the Dutch financial system as a whole. The basic premise is that the financial system should be secured against 'systemic risk,' that is: it should be robust enough to absorb the shock of an individual bankruptcy and thus to prevent a domino effect. DNB has been given, under the Act on the Supervision of the Credit System (including several amendments) a set of supervisory instruments enabling it to target such systemic risk. During the 1980s and 1990s, DNB's duties were further expanded to include supervision of collective investment entities and exchange offices.

Reforms in supervision and the merger with the PVK

Until the late 1990s, financial supervision in the Netherlands was sector-based, with DNB being responsible for the supervision of banks, collective investment entities and exchange offices. The Netherlands Authority for the Financial Markets (AFM) supervised securities firms and the stock exchange, while the Pensions and Insurance Authority of the Netherlands (Pensioen- en Verzekeringskamer, PVK) kept an eye on pension funds and insurance companies.

However, financial sector institutions diversified and merged at an ever increasing rate. For one thing, insurance products were no longer offered exclusively by insurers but also by banks. Financial products, too, acquired mixed characteristics, as in the case of investment mortgages, which have both lending and investment characteristics. In 1999 DNB, AFM and PVK created the Council of Financial Supervisors (Raad van Financiële Toezichthouders, RFT). By mutual consent, the three supervisors decided to abandon the sector-based approach and to replace it by a division of duties into 'prudential' and 'market conduct' supervision.

Under the new regime, DNB was given responsibility for the prudential supervision of financial institutions and the supervision of the financial system as a whole ('systemic' supervision). The AFM was to supervise institutions' market conduct, including consumer protection. The PVK also exercised prudential supervision, but only of insurers and pension funds. Prudential supervision looks mostly at firms' financial position and the level of expertise and trustworthiness of their directors and owners. Market conduct supervision looks at the way institutions treat their customers. The new division into prudential and market conduct supervision in the Netherlands was an important step from a European perspective as well.

The next logical step in the reform of financial supervision was the merger between DNB and PVK, since both exercised prudential supervision over financial institutions. The merger took place on 30 October 2004, from which date the new organisation continued under the name of De Nederlandsche Bank.