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Central bank and prudential supervisor of financial institutions

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Contents

This publication has been prepared by the Statistics and Information Division (telephone +31 20 524 1990, telefax +31 20 524 2512).

Introduction

This issue of the Statistical Bulletin contains three articles. The first discusses the credit approval standards applied by Dutch banks to credit and loans to their customers in the Netherlands and elsewhere in the euro area. Since the second half of 2007, when the crisis in the financial market became increasingly visible, these standards have been tightened. This is shown by the Bank Lending Survey (BLS), a quarterly survey conducted by DNB among three large and three smaller Dutch banks – for the benefit of the monetary policy pursued by the ECB. In this (non-quantitative) survey banks motivated the rising risk surcharges, smaller loans / lower credit lines and stricter collateral demands seen over the past two years, with higher cost of funds, tighter balance sheet restraints and bearish expectations regarding the general economic activity and the housing market. The 'tightening indicator', a balance of responses varying from 'tightened considerably' to 'eased considerably' rose for loans and credit to enterprises from 0% (neutral) in the second quarter of 2007 to 100% in the fourth quarter of 2008, when all six banks reported a tightening of credit standards. Whereas during the first half of 2009, the percentage dropped again, it remained positive (at ca. 60%). The loans for house purchase indicator, after rising likewise, remained stable at over 80%; however, banks expected to tighten house purchase loan conditions a little less severely in the third quarter. Meanwhile, the economic crisis has also made enterprises and households more reluctant, on balance, in their demand for loans and credit, the BLS further shows. According to the surveyed banks, the drop in demand was associated mainly with lower corporate investments, fewer mergers and acquisitions, deteriorating labour market conditions and declining confidence in general economic conditions.

Following earlier articles about so-called special financial institutions (SFIs), this issue of the Statistical Bulletin presents an article on different types of SFIs and the extent to which they have shown different developments in recent years under the impact of the financial and economic crisis. Some 13,000 SFIs have registered offices in the Netherlands: as captive companies of foreign corporations, SFIs offer little if any production or employment but serve as financial hubs for/between foreign-based group companies. The most numerous category, SFIs performing holding activities, shows a balance sheet total of some EUR 1,400 billion, or two-thirds the total of all SFIs. Until 2007, direct investments in, and by, SFIs had consistently grown, but the year 2008 saw a drop, associated to some extent with the global decline of merger and acquisition activity. In 2008 bank SFIs, that is, SFIs belonging to foreign banking groups, presented an image dominated by outward redemptions of bank loans and bonds, possibly reinforced by the credit crisis, which was characterised by a temporary dip in interbank financing. Non-bank SFIs, by contrast, saw their strong growth in activities of recent years continue. In 2008 they issued foreign bonds worth twice the amount recorded in 2007. This, too, may have been associated with the credit crisis, as the issuing spurt coincided with reduced recourse to financing via the banks, which experienced mushrooming difficulties in 2008.

The last article discusses life insurers in the Netherlands. Life insurers constitute the largest segment, by balance sheet total, of the insurance market. Accordingly, the amount of money involved in premiums for products such as annuities or investment-based life insurance is substantial: EUR 26 billion. Between 1996 and 2001, life insurers realised considerable premium income growth. In recent years, however, the rise in premiums flagged, levelling off at some EUR 26 billion per year (the amount needed for asset building and insurance). Meanwhile collective insurance, bringing in one-third of total premium income, has continued to grow. Insurers have catered to employers' need for pension schemes by offering tailored products. Also, they offer possibilities for smaller pension funds wishing to outsource their investments. The turnover in individual life policies has dropped, however, despite increasing demand for individual pension plans. This is due to, on the one hand, a limitation of the tax benefit allowed for annuity plans, and the introduction of tax favoured bank saving on the other, changing the competitive conditions vis-à-vis the banks. Demand for investment-based insurance further declined amid media coverage criticising such products' transparency and costs.

Recent developments in bank credit standards

One of the information sources the ECB uses in framing its monetary policy is the Bank Lending Survey, a qualitative quarterly survey of European banks' credit policies. In the Netherlands, DNB asks a number of banks to report changes in interest rates, maturities, collateral requirements, credit lines and other criteria applied in considering loan applications by enterprises and households. Banks also asked why they changed their credit standards. The survey outcomes since early 2007, the main topic of this article, indicate a tightening of credit standards, especially where large corporations and large loans are concerned. Since early 2009, the number of banks tightening standards has been falling off. Although for housing mortgages the tightening continues, fewer banks than before expect to further tighten their credit standards for housing mortgages during the third quarter of 2009.

Introduction – The Survey

Developed by the European System of Central Banks, the Bank Lending Survey is designed to provide a more accurate insight into the pass-through of monetary policy. Over half the questions relate to the supply side of lending, and most of the others to the demand side (for details on the Survey, see the diagram below this article).[1] The questions concern the changes during the most recent three months (vis-à-vis the preceding quarter). Banks are also asked to look three months ahead, both as regards their lending policy and as regards credit demand. A distinction is made between loans to small and large-sized enterprises (annual turnover over EUR 50 million), between short-term and long-term loans and – in the case of households – between mortgage loans for house purchasing, on the one hand, and consumer credit and other lending on the other. The questionnaire uses a five-point scale ranging, in the case of credit standards, from 'tightened considerably' to 'eased considerably' (via 'tightened somewhat', 'basically unchanged' and 'eased somewhat').[2] The answers are combined into a single *net percentage*, i.e. the difference between the percentages of tightening and easing banks (banks with unchanged policies are disregarded). If, for instance, 40% of banks tightened conditions and 10% eased conditions, this comes out as 30% tightening for the banking industry as a whole. (No distinction is made here between 'somewhat' and 'considerably'.)

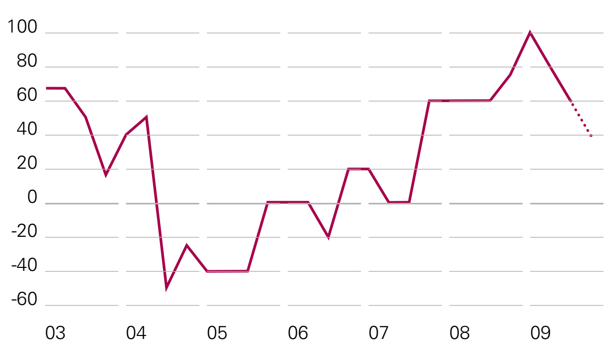
Currently, a sample of 118 banks in the 16 euro area countries (picked at the national level) participate in the Survey. Together, participants cover circa 50% of total bank lending to households and enterprises in the euro area. Six Dutch-based banks are included in the sample (three large, three non-large), together covering about 75% of total lending to enterprises and households located in the Netherlands or elsewhere in the euro area. Answers relate to counterparties inside the euro area, which in practice reside mainly in the Netherlands. National outcomes are aggregated, after weighting for the share each country contributes to total lending in the euro area, into figures for the euro area. No weighting is applied at the national level, so that all banks have equal weight.[3]

Lending policies in the Dutch banking industry

Corporate lending

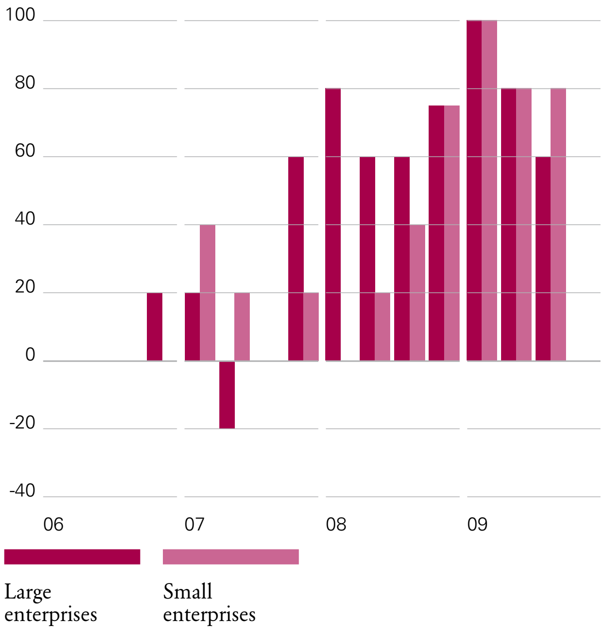
The sampled banks in the Netherlands (hereafter referred to as the banks) tightened the approval criteria for new loans to enterprises or new credit lines in the fall of 2007. For the third quarter of 2007, 60% (net) of banks reported accordingly (Chart 1). In that same period, the unrest in the financial markets began to increase amid the deteriorating situation regarding the US subprime mortgage market. In the course of 2008, all banks reported tightening (the indicator for the fourth

Chart 1 Net % of banks tightening credit standards for enterprises in NL and the euro area compared to the preceding quarter (2009Q3 is projection)



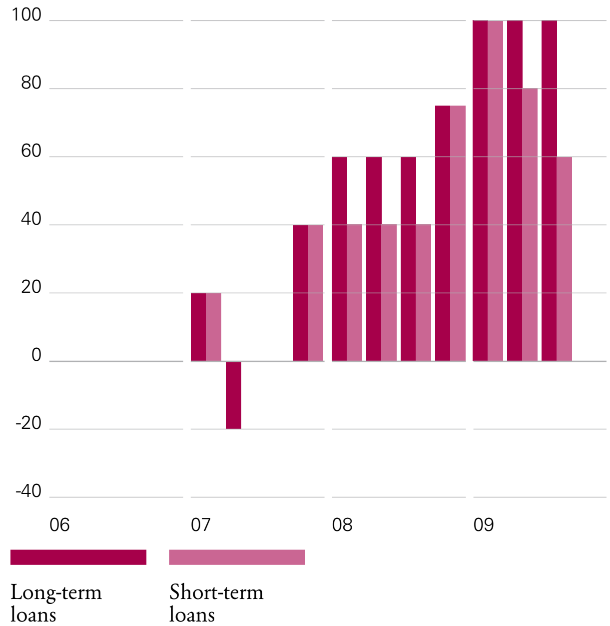
Explanation: Net percentage represents the share of banks that tightened credit standards minus the share of banks that eased credit standards. Banks with unchanged credit standards are disregarded. +100 = all banks reported tightening.

Chart 2 Tightening of conditions for large and small enterprises



Note: +100 = all banks in the Netherlands reported tightening.

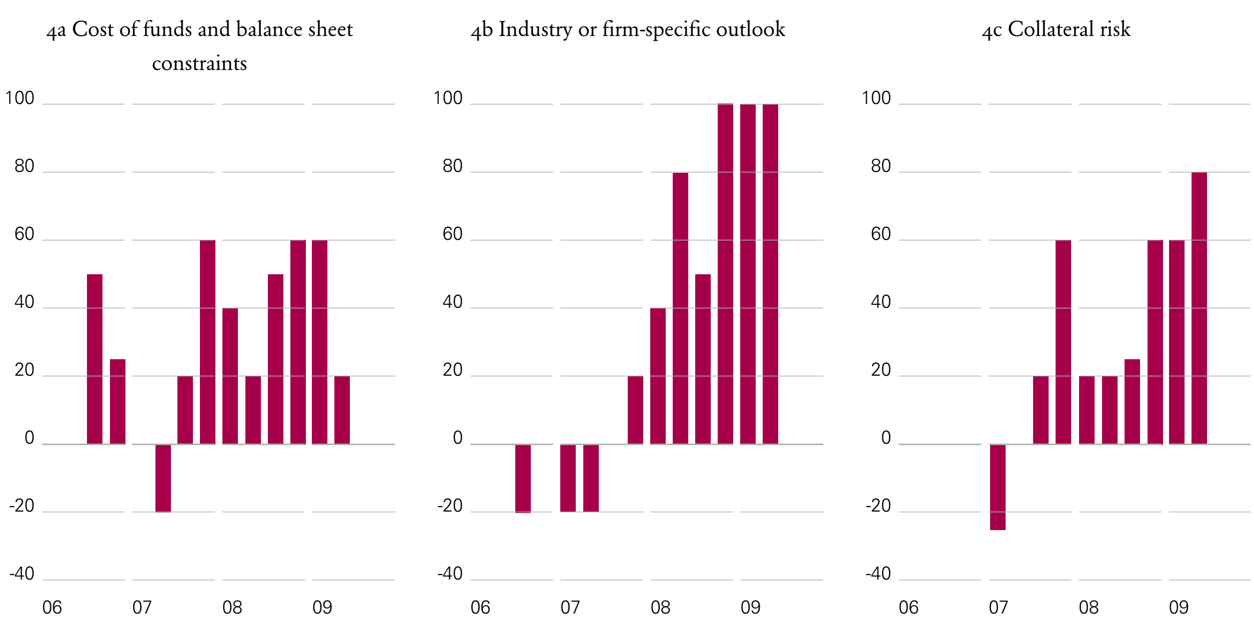
Chart 3 Tightening of conditions for long-term and short-term loans



Note: +100 = all banks in the Netherlands reported tightening.

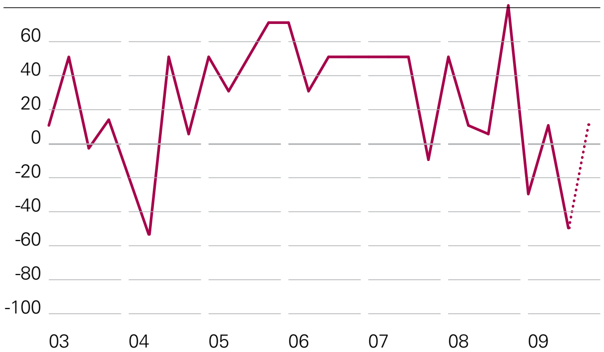
Chart 4 Factors affecting credit standards applied to the approval of loans or credit lines to enterprises, compared to preceding quarter

Net % of banks reporting tightening



Note: +100 = all banks reported tightening.

Chart 5 Net % of banks in NL experiencing changes in demand for loans or credit lines to enterprises, compared to the preceding quarter (2009Q3 is projection)



Explanation: Net percentage represents the share of banks that experienced rising demand minus the share of banks that experienced falling demand. Banks with unchanged loan conditions are disregarded. +100 = all banks reported rising demand.

quarter of 2008 rose to 100%). In 2009, the number of tightening banks declined again, but none reported easing of credit standards. Enterprises both big and small faced stricter criteria in 2009, whereas in 2008 this had applied mainly to large companies (Chart 2).

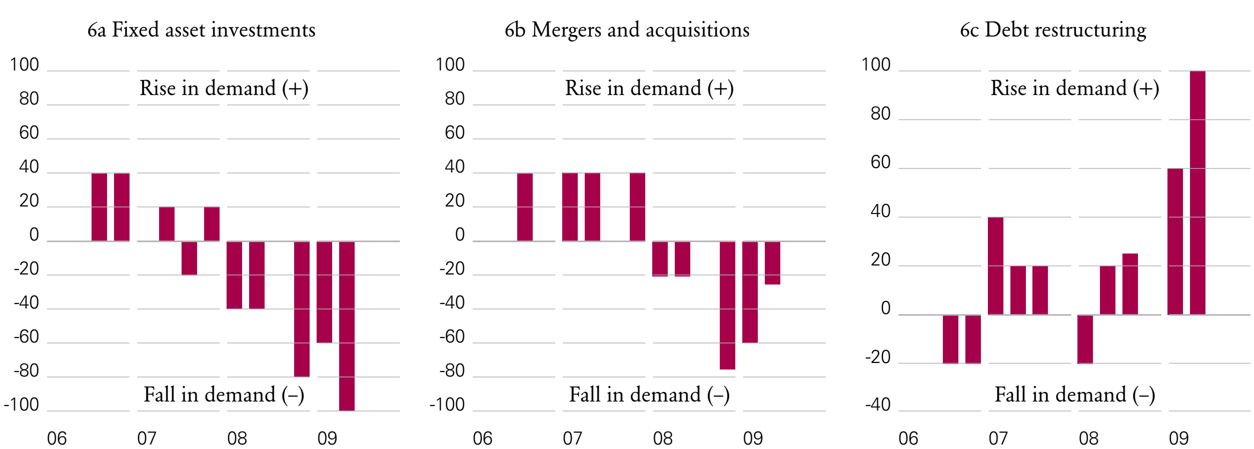
Also from mid-2007 onwards, banks started tightening conditions on both short-term and long-term credit; as regards long-term loans, more banks reported tightening (Chart 3). As reasons for tightening banks, apart from increased cost of funds and balance sheet constraints (Chart 4a), also cited negative expectations regarding general economic activity and a negative industry or firm-specific outlook (Chart 4b). Furthermore, banks' increasing refinancing difficulties in the financial markets in the course of 2008 and growing risks posed by collateral to corporate credit (Chart 4c) also contributed to the tightening of bank credit conditions. In the most recent Survey (on the second quarter of 2009), however, fewer banks than before cited cost of funds and the balance sheet as constraining corporate lending.

The tightening of credit standards was reported by banks to be reflected in *contract conditions* on new loans. In reaction to the deteriorated economic circumstances, banks raised the price of credit by increasing risk premiums. Tightening also showed up in loan covenants on, for instance, the maximum ratio between a company's debts and gross profits. Furthermore, banks tightened policies by reducing the size of loans and by making stricter demands regarding collateral on corporate credit.

In late 2007, banks reported a decline in enterprises' demand for lending, for the first time since October 2004 (Chart 5). The years 2008-09 presented a volatile pattern of rising and dropping demand around a falling trend, in line with deteriorating economic conditions. Increasing numbers of banks (net 80% in the second quarter of 2009) reported a decreasing demand for loans citing a drop in fixed asset investments (Chart 6a) and

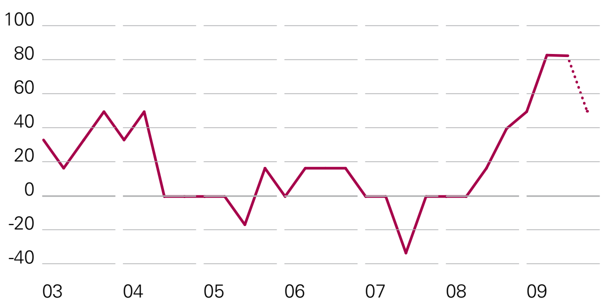
Chart 6 Factors affecting changes in demand for loans or credit lines to enterprises, compared to the preceding quarter

Net % of banks



Note: –100 = all banks experienced a fall in demand.

Chart 7 Net % of banks in NL tightening credit standards for house purchase loans, compared to preceding quarter (2009Q3 is projected)



Explanation: Net percentage represents the share of banks that tightened credit standards minus the share of banks that eased credit standards. Banks with unchanged credit standards are disregarded. +100 = all banks reported tightening.

low merger and acquisition activity for 2009 (Chart 6b). Meanwhile, banks reported increased demand for corporate loans in connection with debt restructuring[4] (Chart 6c). The share of Dutch banks that envision a further decrease of credit demand in the third quarter of 2009 declined (Chart 5).

Mortgage lending

About one year after banks first reported tightening corporate lending policies, several banks were tightening conditions on loans for house purchase as well. A majority (net 40%) of banks had reported a tightening of mortgage credit standards in the third quarter of last year. In following quarters, more banks followed suit (Chart 7).

The reason for tightening cited by banks included increased cost of capital position (Chart 8a). Also, banks perceived two major risks looming in the course of 2008 and, especially, 2009: the deterioration in 'general economic activity' (Chart 8b) and the deteriorating outlook for the housing market (Chart 8c). Banks tightened their mortgage credit standards by extending lower loans compared to the appraised collateral value and through a margin on mortgage rates. For the third quarter, however, the share of Dutch banks expecting a further tightening declined.

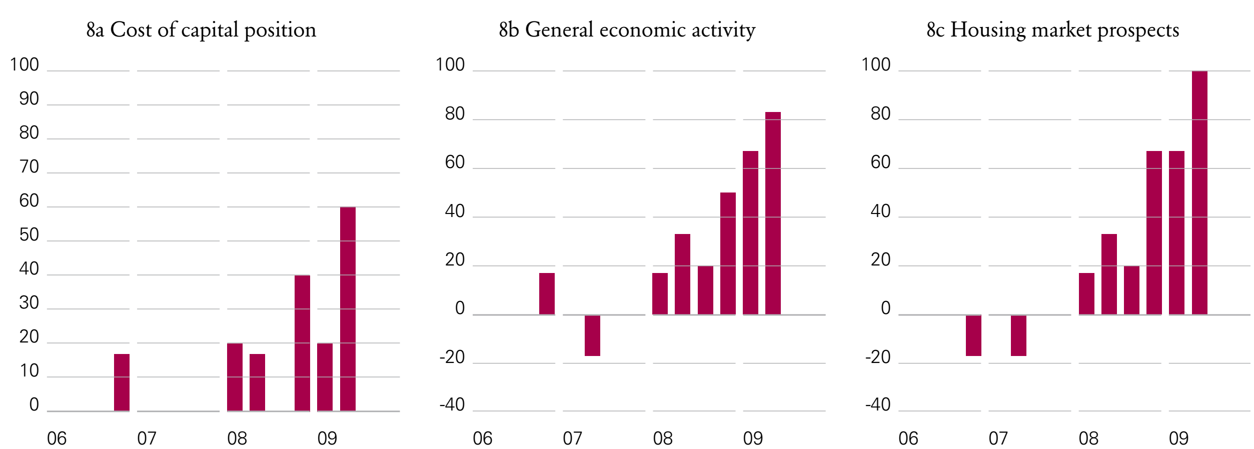
Households became more cautious, too. During 2007, increasing numbers of banks noted a decrease in the funding need of home buyers (Chart 9), which they ascribed to a sharp decline in consumer confidence and an increased propensity to save in response to the negative effect of a declining stock market on consumers' wealth position.

Consumer credit and other lending

As in the case of mortgage loans, a majority of banks in the Netherlands also tightened their conditions on consumer credit and other lending to households (such as securities-backed loans) as of the second half of 2008

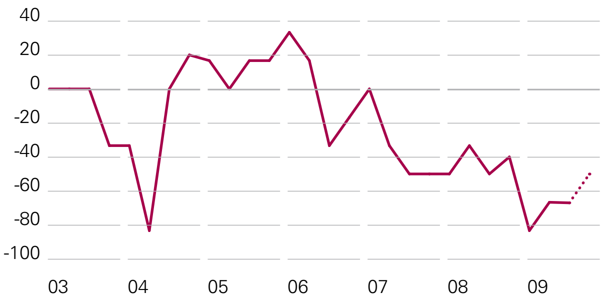
Chart 8 Factors affecting tightening of conditions for house purchase loans, compared to the preceding quarter

Net % of banks



Note: +100 = all banks reported tightening.

Chart 9 Net % of banks experiencing a change in demand for house purchase loans, compared to the preceding quarter (2009Q3 is projection)



Explanation: Net percentage represents the share of banks that experienced rising demand minus the share of banks that experienced falling demand. Banks experiencing no change are disregarded. +100 = all banks reported tightening.

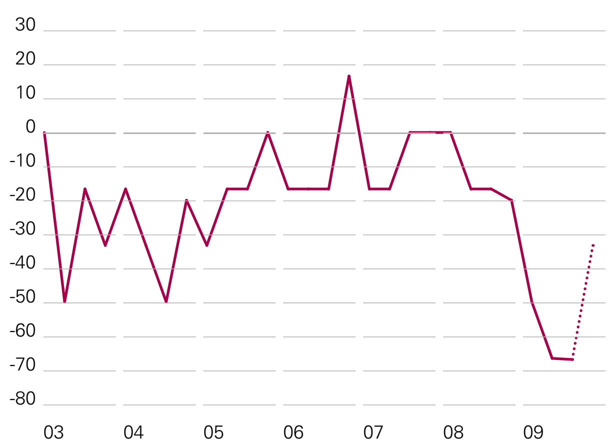
Chart 10 Net % of banks in NL tightening credit standards for consumer credit and other lending, compared to preceding quarter (2009Q3 is projected)

Explanation: Net percentage represents the share of banks that tightened credit standards minus the share of banks that eased credit standards. Banks with unchanged credit standards are disregarded.

(Chart 10). Most banks continued to report such tightening during the first half of 2009. This, banks thought, was also associated with the cost of funding and balance sheet constraints, a falling economic growth rate, increased collateral risks, deteriorating labour market prospects and declining consumer creditworthiness. Banks tightened their credit standards through more stringent collateral demands and a higher interest rate margin.

In the course of 2008 and 2009, increasing numbers of banks identified a decrease in demand for consumer credit and other lending (Chart 11), due especially to falling consumer confidence and a substantial contraction of spending on durable consumer goods. By contrast, moreover, banks found that savings increased.

Chart 11 Net % of banks experiencing a change in demand for consumer credit and other lending, compared to the preceding quarter (2009Q3 is projection)



Explanation: Net percentage represents the share of banks that experienced rising demand minus the share of banks that experienced falling demand. Banks experiencing no change are disregarded. +100 = all banks repoited rising demand.

Concluding remarks

The Bank Lending Survey indicates that from mid-2007, banks in the Netherlands tightened their lending policies vis-à-vis enterprises and, later, vis-à-vis households. Most banks also report facing a decrease in credit demand owing to global economic recession. Yet for the third quarter, fewer banks than hitherto expect corporate credit demand to decrease.

1 Earlier articles on the BLS appeared in the June, 2003 and June 2004 Statistical Bulletins.
2 In the Survey paragraphs on credit demand, 'tighten' and 'ease' are replaced by 'decrease' and 'increase'.
3 Apart from the countries of the euro area, similar surveys are also held in the United States and Japan. Owing to the sometimes

strong structural differences between national banking industries, the outcomes of national surveys cannot be compared.
4 Debt restructuring includes, among other things, the conversion of short-term debts in long-term debts, equity or convertible bonds.

Table of questions posed to banks in the Bank Lending Survey

		Change in credit approval standards?	Which factors affect credit approval standards?	Which loan conditions changed?
CREDIT SUPPLY	* corporate lending	tightened / unchanged / eased ?	A Cost of funds & balance sheet constraints - cost of solvency - access to fin. markets - liquidity position	A Price - margin on avg. loans - margin on riskier loans
		small / large enterprises? short / long term?	B Competitive pressure - competition other banks - competition non-banks - competition from financing by other market parties	B Other standards - costs excl. interest - size of loan / credit line - collateral requirements - loan covenants - maturity
			C Risk perception - expected economic activity - company/industry prospects - collateral risk	
	* loans for house purchase, consumer credit and other loans to households	tightened / unchanged / eased ?	A Cost of funds & balance sheet constraints B Competitive pressure - competition other banks - competition non-banks C Risk perception - expected gen. economic activity - housing market prospects - collateral risk - consumer creditworthiness	A Price - margin on avg. loans - margin on riskier loans B Other standards - Costs excl. interest - Loan-to-value ratio - Collateral requirements - Maturity

		Change in credit demand?	Which factors affect credit demand?
CREDIT DEMAND	* corporate lending	decreased / unchanged / increased?	A Financing needs - fixed investments - Inventories and working capital - mergers / acquisitions - debt restructuring
		small / large enterprises? short / long term?	B Alternative sources of finance - internal financing - loans from other banks - loans from non-banks - issuance of debt securities - issuance of equity
	* loans for house purchase, consumer credit and other loans to households	decreased / unchanged / increased?	A Financing needs - housing market prospects - consumer confidence - non-housing related consumption expenditure - spending on durables B Use of alternative finance - household savings - loans from other banks - other sources of finance

OPEN QUESTION: Was borrowing behaviour affected by any other developments?

These questions are also posed with reference to the next three months.

Stagnation at bank SFIS, growth in activities of other SFIS

Special Financial Institutions (SFIS) are entities established in the Netherlands by foreign multinational companies as throughput channels for financial flows among foreign group companies. The size of these flows is considerable. The gross (summed) inflow and outflow via Dutch SFIS in 2008 amounted to more than EUR 12,300 billion and SFIS' total assets outstanding abroad (the balance sheet total) at year-end 2008 was also considerable at well over EUR 2,100 billion. As they function solely as conduits for foreign companies, the direct impact of SFIS on the Dutch economy is, however, smaller than these figures would suggest. That is why DNB publishes the data of the balance of payments (and the net external asset position) of the Netherlands both including and excluding SFIS. This article deals with the objectives and activities of SFIS. There are various types of SFIS, which all have experienced different developments in recent years. At SFIS belonging to banking firms the balance sheet total decreased. In contrast, the activities of non-bank SFIS further increased. To be sure, growth of foreign direct investment in such SFIS fell, but this was compensated for by a doubling of capital inflow as a result of securities issues.

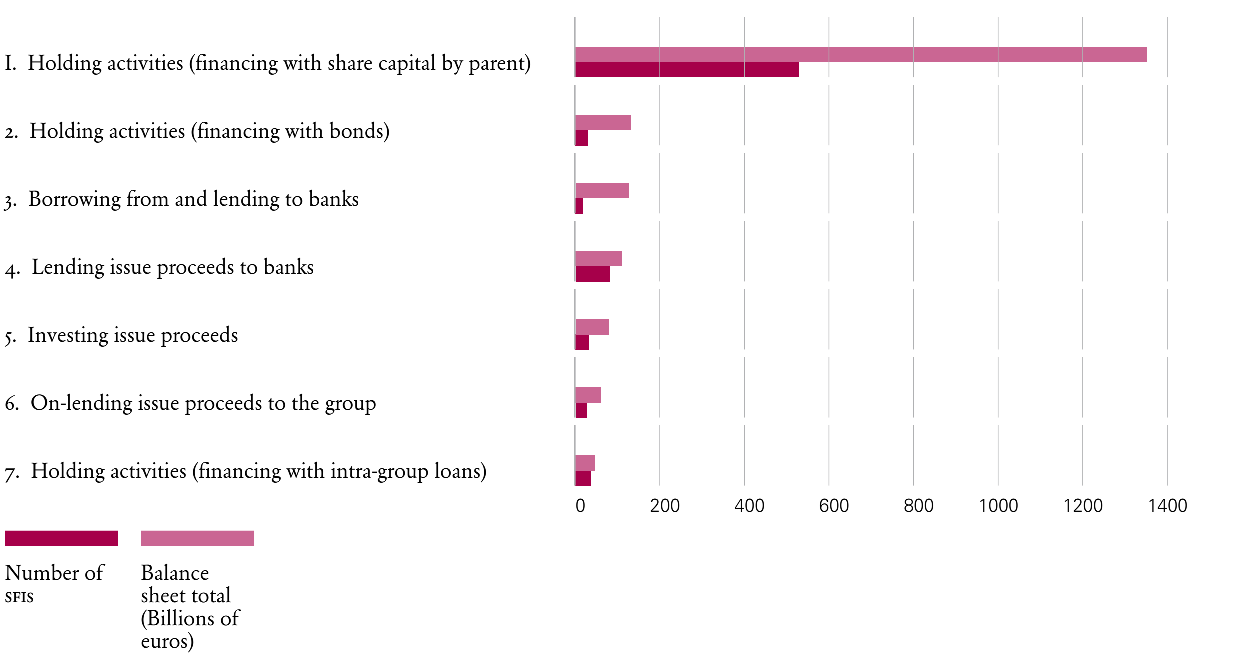
Introduction - A typology of SFIS

First, this article briefly introduces the various types of SFIS. This is followed by developments in the size of the total activities of SFIS and of specific assets and liabilities, split up into bank and non-bank SFIS.

The Netherlands have some 13,000 SFIS. These are usually controlled directly from their foreign head office and in the Netherlands they hardly employ staff, if any. The financial flows via those SFIS vary (shares, loans, etc.). SFIS may finance themselves outside and/or inside the foreign company to which they belong. A first main categorisation of Dutch SFIS is therefore the following:

1. Intra-group-funded holding and finance companies
Most SFIS are holding and/or finance companies. The majority of these (more than 90%) have financial relations with other group companies. These mainly concern majority participations and longer-term intra-group loans, i.e. capital which is channelled from one foreign group company to another via the Dutch SFI.

Chart 1 Typology of SFIS by main activity in 2008

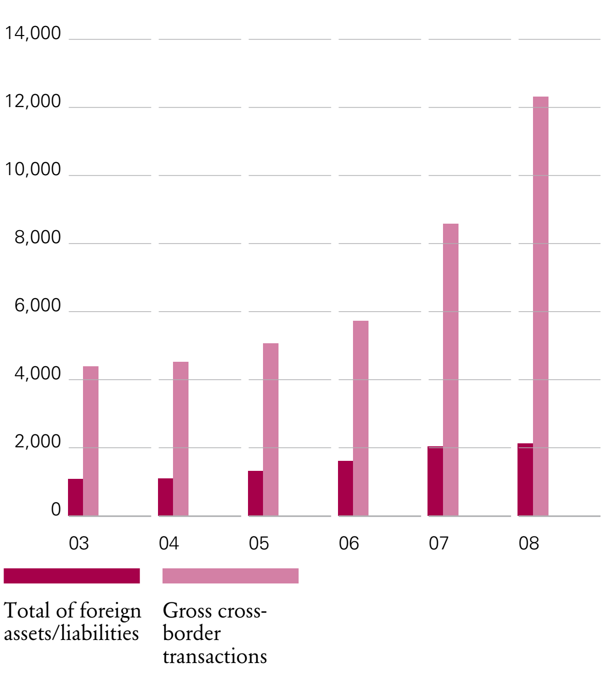


2. Externally funded finance companies
There is also a category of SFIs which principally attracts resources abroad on the money or capital markets, or finances itself through private or bank loans. For example, many SFIs issue securities abroad (often bonds) and subsequently provide the funds raised in the form of participations in or loans and agreed overdrafts to foreign group companies. Such SFIs are used by e.g. banking firms as a source of funding. The Netherlands also has many special purpose vehicles (SPVs). SPVs with a foreign 'originator'/founder and predominantly foreign assets and liabilities can also be SFIs. They obtain packages of claims from the originator, for example mortgage loans or loans to companies provided by banks, and finance these by issuing debt instruments abroad.

At most SFIs, one type of asset and one type of liability are dominant. Besides the above finance method, SFIs can therefore also be categorised by their main activities (Chart 1).

By far the largest category of SFIs is formed by SFIs with holding activities (Type 1), both in terms of balance sheet totals (more than EUR 1,350 billion) and numbers (528). Looking at numbers, the second place is for SFIs which predominantly issue securities and use the issue proceeds for loans to banks (80 in number, with a balance sheet total of EUR 110 billion). In terms of volume, the second place is for SFIs which also issue securities, but use the proceeds to finance participations (EUR 130 billion, 31 SFIs). Not mentioned separately in Chart 1, but divided over the various categories are the bank SFIs, which belong to or are associated with a foreign bank company (at year-end 2008 almost 70 SFIs and clusters of SFIs, representing a balance sheet total of EUR 400 billion). In some categories in Chart I these bank SFIs are clearly over-represented, especially at Type 3 (lending from banks and providing loans; accounting for 95% of the total amounts) and Type 5 (investing with issue proceeds; 77%) As with nearly all SFIs, holding activities are important for these SFIs, but in this category they only accounted for 8% at year-end 2008.

Chart 2 Foreign position and gross transactions of SFIs based in the Netherlands
EUR billion



Continuing growth of the activities of the SFI sector

Over the past years, SFI activities have increased sharply, also during the credit crisis. The gross amount of incoming *plus* outgoing transaction flows between 2003 and 2008 nearly tripled to over EUR 12,300 billion. In particular during the last two years, possibly as a result of the increased unrest in the financial markets, the rise in transactions was robust. Stocks of foreign assets and liabilities of SFIs increased as well, but did not keep pace with the transactions. They doubled over the same period, to more than EUR 2,100 billion (Chart 2).

For the balance of payments, the assets and liabilities of SFIs at foreign counter parties classify as direct investment (consisting of participations and other transactions between associated companies), securities, financial derivatives and other financial transactions (in the case of SFIs mainly bank loans and bank deposits). Between 2003 and 2008, direct investment from the Netherlands via SFIs doubled to roughly EUR 1,800 billion and incoming direct investment to EUR 1,500 billion (Figure 3). This amounts to an average annual growth of 15 per cent. The increase is considerably higher than that of direct investment in the Netherlands excluding SFIs, which in the same period rose by an average of 6 per cent a year. For instance, the share of SFIs in total incoming direct investment consequently rose to approximately 75%.

Meanwhile, the issue of securities also gained momentum as a funding source for SFIs. Stocks of issued securities augmented from EUR 300 billion to more than 400 billion. Following a very sharp increase in 2007, the remaining financial transactions showed a slight decline on the assets and liabilities side to EUR 300 and 220 billion respectively in 2008.

Chart 3 Developments in foreign assets and liabilities, all SFIs, stocks
EUR billion

Opposing developments at bank and non-bank SFIs

Through the years the number of bank SFIs has shown unremitting growth. At the end of 2008, the Netherlands had 68 registered individual SFIs and clusters of bank SFIs. Many widespread types of bank SFIs are (variants of) SPVs, conduits, issuance centres and other institutions which commonly finance themselves through issues. Holding activities (on the balance of payments classified as direct investment), advances by way of intra-group loans (also classified as direct investment) and investments of issue proceeds (securities transactions) form their main activities. Their balance sheet total at the end of 2008 stood at approximately EUR 400 billion. Another separate activity is the derivates business (which in 2008 held EUR 51 billion in assets), an activity in which mostly issuance centres specialise. These are large bank SFIs which borrow money for the benefit of the entire company to which they belong through issues on the international capital markets or from other parties outside the company and hedge their positions with derivatives.

From 2004 to 2006 the activities of bank SFIs measured by transactions grew steadily, followed by a very sharp rise in 2007 (Chart 4). Their balance sheet total in that year increased by as much as EUR 255 billion, more than twice that of non-bank SFIs. Loans to affiliates of bank groups increased by EUR 150 billion. In 2008 on the other hand, activities of bank SFIs dropped sharply, causing balance sheet totals to drop. Following the high loans in 2007, the year in which the financial crisis took off, now, perhaps partly due to a reduced financing need, approximately EUR 30 billion was redeemed. Only incoming direct investment in bank SFIs remained at the same level (EUR 10 billion). The bankruptcy of Lehman Brothers, to which the Dutch SFI Lehman Brothers Treasury Co belonged, also played a part.

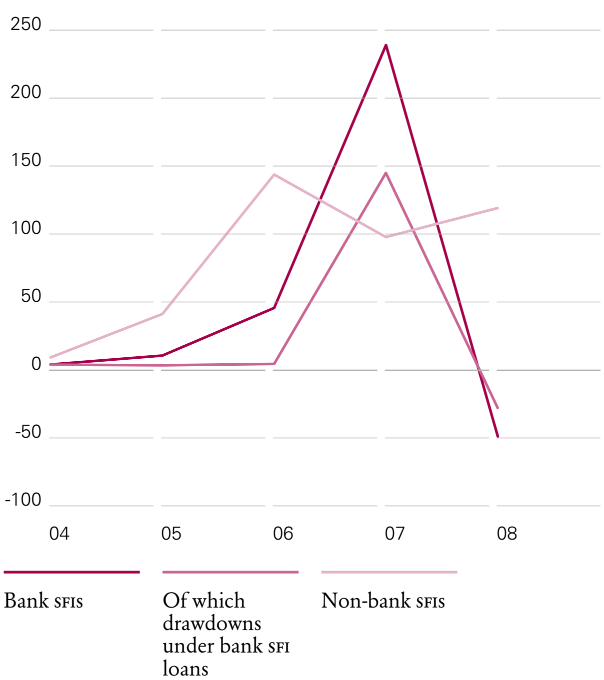
In this respect, bank SFIs strongly deviated from non-bank SFIs, whose liabilities increased from some EUR 1,500 billion in 2007 to almost EUR 1,750 billion in 2008. Instead of decreasing, in that year inflow of capital even edged up a bit, despite a drop in incoming direct investment, which from 2003 to 2007 had unremittingly augmented (Chart 5). The growth continued because in 2008 non-bank SFIs, possibly in combination with a reduced recourse to bank financing by other group companies, issued a multiple of debt instruments of what they had spent in previous years.

While the issues of bonds by bank SFIs (EUR 40 billion in 2007) changed into loan repayments (EUR 15 billion in 2008), the issues by non-bank SFIs doubled to EUR 35 billion (Chart 6).

Conclusion

The Netherlands has many thousands of SFIs, which have in common that they channel money but otherwise differ widely. At year-end 2008, holding activities by far constituted the chief activity for approximately

Chart 4 Inflow of capital at bank and non-bank SFIs
EUR billion



three quarters of the SFIs. For some smaller categories of SFIs, however, maintaining connections with foreign banks and bond issuance made up the main activities. This holds especially true for bank SFIs, which despite their small numbers (68 out of the 870 SFIs that are subject to reporting requirements) still represent approximately one fifth of the overall SFI sector in the Netherlands with a balance sheet total of EUR 400 billion. In 2008, however, a year in which the banking sector worldwide was confronted with ever bigger problems, growth of this sector stagnated. This was notably perceivable, for instance, on the liabilities side of the balance sheet by way of a strong drop in demand by bank SFIs on (intra-group) loans, and also in stagnation in the issuance of securities. However, for non-bank SFIs the (strong) growth of activities continued. For a larger part than before, they were now also financed through the issue of bonds, which in 2008 doubled.

Chart 5 Inflow of capital at non-bank SFIs
EUR billion

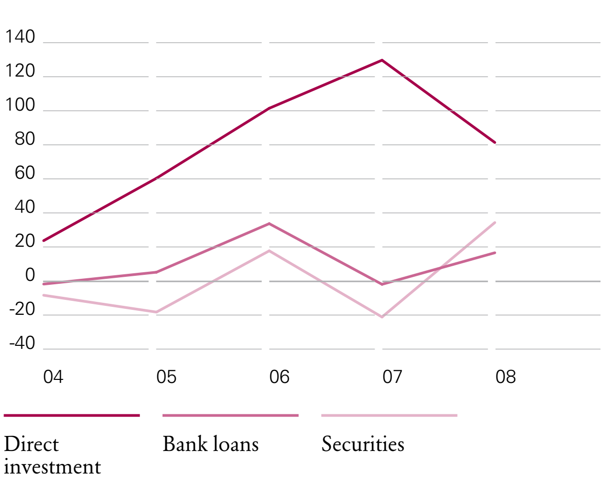
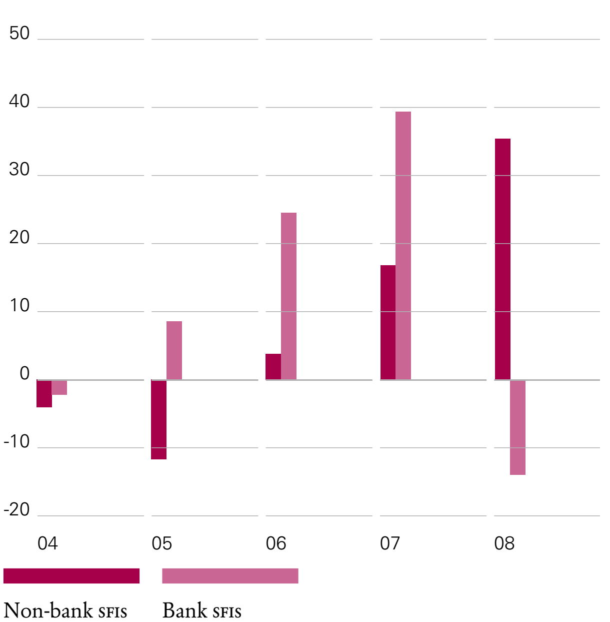


Chart 6 Net issue of securities by Dutch SFI's
EUR billion



1 See Tables 12.1 and 12.13 as well as 12.10 and 12.14.
2 For developments on SPVs, see the articles in the Statistical Bulletins of June 2008 and June 2009.
3 The Dutch SFI sector also includes a small group of SFIs specialising in channelling royalty and licensing proceeds. There are also SFIs which channel the proceeds of re-invoicing and operational lease activities.
4 For this breakdown by main activity we looked at the composition of the *balance sheets* of the 10% largest SFIs, 870 SFIs and SFI clusters, by size representing approximately 90% of the total activities of the 13,000 Dutch SFIs. A number of relatively small categories (calculated by balance sheet totals) are not represented in the chart.
5 If several SFIs established in the Netherlands belong to the same foreign company and, in addition, hold mutual assets and liabilities, they are referred to as clusters of companies, which together perform the SFI activities.
6 In view of the channelling character of SFIs, stocks of foreign assets and liabilities by definition more or less match up.
7 Incidentally, intra-group bank loans, unlike those of non-bank SFIs, are not classified as direct investment but as other financial transactions. The reason is that lending or withdrawing money is part of banking activities and therefore not necessarily implies a participation-linked capital injection.

Life insurance premiums stabilise at EUR 26 billion

Life insurers constitute the largest segment, by balance sheet total, of the insurance market. Accordingly, the amount of money involved in premiums for products such as annuities or unit-linked life policies is substantial: EUR 26 billion. Between 1996 and 2001, life insurers realised considerable premium income growth. Recent years, however, have seen only a very limited increase in premiums. While collective policies continue to grow, income from individual policies has dropped. Factors affecting this development are changes in tax legislation and growing competition from other financial parties.

Introduction

Saving for later, for retirement or for redemption of a mortgage debt – you may do so with a bank but also with a life insurance company. Insurers combine such savings products with insurance policies. Normally speaking, the sum accrued with the insurer will be disbursed when the savings plan matures. If the insured dies before that date, however, despite the fact that not all premiums have been paid, the insured amount will be paid in full under the linked life insurance policy. Another example is the guaranteed lifelong annuity. The premium associated with guaranteed commitments to the policyholder will be determined on the basis of their estimated life expectancy. Total gross life insurance premiums, including both asset building deposits and insurance premiums, ran to EUR 26 billion in 2008 (4% of GDP).[1, 2] This amount has been more or less stable for some years. When adjusted for inflation, it has declined by EUR 3 billion compared to 2001, when the market peaked. This article discusses the underlying causes of the stabilisation, and reviews the assets accrued with insurers by private policyholders.

Individual life insurance policies

Private persons may take out an *individual* life insurance policy with one of the 67 Dutch life insurers for an annuity, for instance, or as part of a mortgage insurance plan. *Collective* insurance for a group of individuals at once is another possibility, used, for instance, by employers to arrange pension plans for their employees. Both individual and collective policies can be either *cash-based* or *unit-linked*. The first is similar to a savings account, including guaranteed payment by the insurer. The second is a combination of insurance and investment, in which the policyholder runs a degree of risk, in contrast to the first option. The four submarkets that may be distinguished on the basis of these aspects (see Figure 1) show considerable dynamics over the years, mainly as a result of changes in tax exemption, the business cycle and/or stock market prices.[3]

Cash-based insurance

By total premiums, the submarket of individual insurance was largest (EUR 17 billion in 2008), almost twice as large as the collective insurance submarket (EUR 9 billion). Premiums for all individual insurance types – new single-premium policies as well as periodic payments towards previously arranged policies – have risen by 5%, on average, since 1995. Within individual insurance, cash insurance is the most important segment (see Chart 1).

Around the turn of the century, the sale of new cash-based insurance policies was given strong impulses. Shortly before the introduction of the new income tax system in January 2001, for instance, restricting the tax exemption of annuity premiums, there was a peak in new policy sales. The year 2000 and the first three months of 2001 saw EUR 4.8 billion's worth of new sin-

Figure 1 Life insurance premiums in 2008

EUR billion

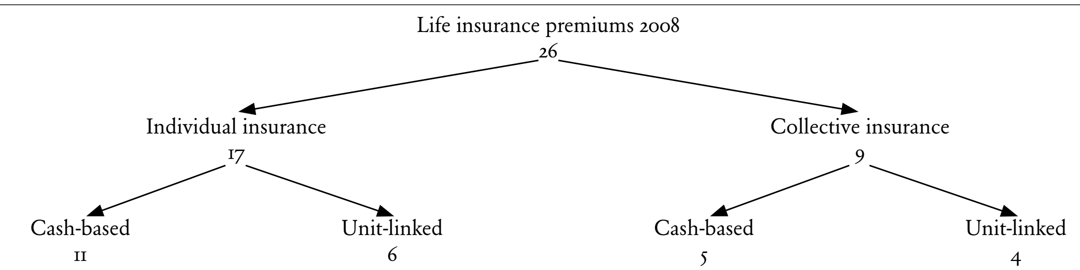
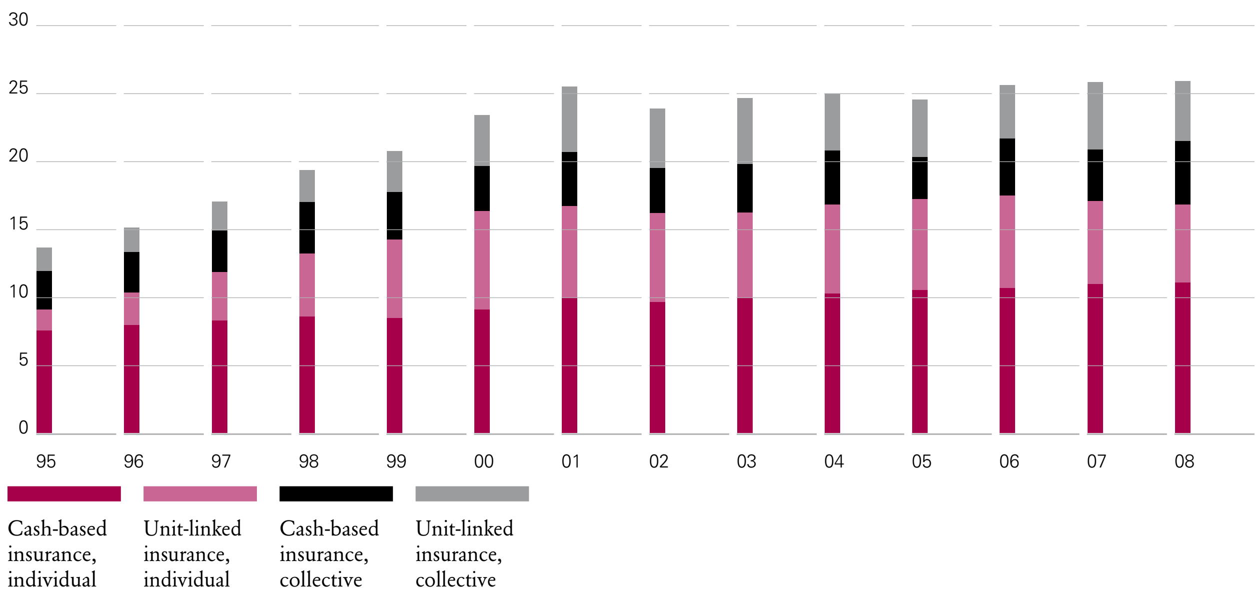


Chart 1 Development of life insurance premiums
EUR billion



gle-premium policies sold, mainly for immediate and deferred annuities; in 1999 new single-premium policies had totalled EUR 2.7 billion (see Chart 2).[4] Shortly afterwards, large numbers of maturing older policies also made for additional sales. In the run-up to the previous tax review, of 1992 (known as the '*Brede Herwaardering*'), which had also included a restriction on the tax exemption of annuity premiums, relatively many policies had been taken out, typically carrying a 12-year maturity. At maturity, policyholders had a choice between having the accrued sum paid out at once, or investing it in an directly commencing annuity. In 2004, this led to payment of almost EUR 2 billion's worth of premiums towards such annuities.[5] In later years, too, maturing policies generated 'new' premiums in the shape of single-premium policy sales.

However, the volume growth of of this annuity product came under pressure as of 2008, when apart from insurers, banks were also permitted to offer tax benefits on savings products; as a result, the insurance sector faced increasing competition for people's savings.[6] Still, according to estimates by the Dutch Association of Insurers (*Verbond van Verzekeraars*) almost 85% of tax-facilitated saving in 2008 (EUR 2 billion) was effected through insurance companies. This may, however, be due to consumers' relative unfamiliarity with the banking product. All in all, premiums on new individual cash-based life insurance policies still grew, in 2008, to EUR 6 billion (single-premium and periodic payments), pushing total sales, including premiums on existing policies, up to EUR 11 billion in the course of over ten years.

Chart 2 New single-premium cash-based insurance policies
EUR billion

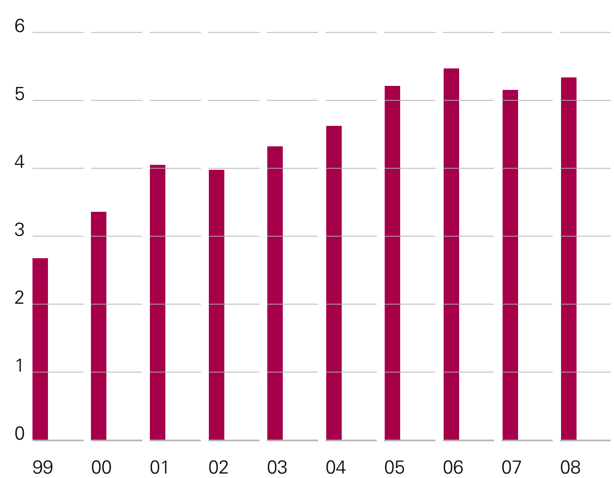
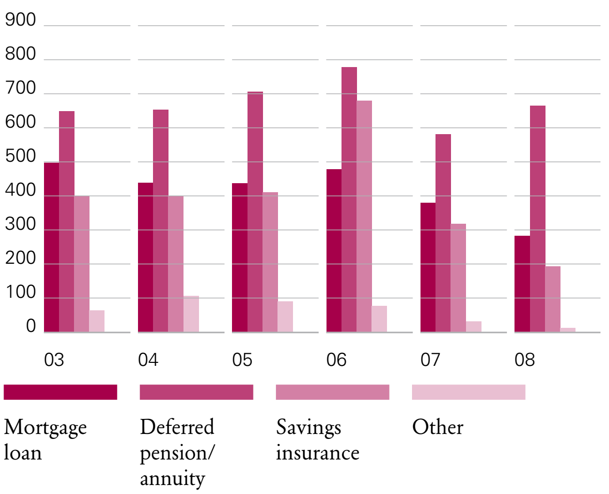


Chart 3 Purpose of new unit-linked insurance policies
EUR million



Unit-linked insurance
Most unit-linked policies are bought to accrue capital to be paid out, as in the form of an annuity, after retirement (see Chart 3). Then there are unit-linked mortgage loans with a term insurance attached, while a third popular type is the (general) savings insurance policy.

The premiums on individual unit-linked policies remained relatively limited until the mid 1990s, when they stood at EUR 1.6 billion. Their average annual growth rate, however, at 10.5%, was much higher than that of cash-based insurance (3%). Thus the share of individually bought unit-linked insurance policies in the total premium volume doubled from 11% in 1995 to 22% in 2008. Growth was not at all steady, though, owing to several generic as well as specific factors.

The main, generic, factor was the development of stock market prices, which influenced private individuals' decisions about whether or not to stake their money on investment products. In the 1997-2000 period many individuals, attracted by the stock market boom, bought new unit-linked insurance policies. At the peak, in 1999, almost 900,000 new policies were sold, bringing in EUR 3 billion in premiums. In 2000, however, demand flagged as policyholders faced considerable investment losses under the impact of a stiff adjustment of stock prices caused by the bursting of the dotcom bubble. In 2006 policy sales picked up somewhat as stock markets recovered. However, a drop occurred after market conduct supervisor AFM had voiced criticism on unit-linked insurance, spawning a public debate on so-called 'profiteer policies' (*woekerpolissen*). The debate hinged on the argument that such policies were often expensive, intransparent and complex. Against this backdrop, the sale of new policies fell from 391,000 in 2006 to 169,000 in 2008, while premium income dropped from EUR 2 billion to a little over EUR 1 billion.[7] Meanwhile periodic premium payments on unit-linked insurance policies have generally continued, because such policies are expensive to buy off.

More specifically, there has been the introduction of so-called 'life-course savings schemes' in 2006, which generated additional sales of new savings policies, followed by monthly premium payments. Offsetting this was a drop in demand for unit-linked mortgages in 2007 and 2008 owing to the credit crisis. The number of house transactions declined, while falling stock market prices induced consumers to take out savings-linked mortgage loans. All in all, total annual deposits – including instalment payments on current policies – which in 2000 still amounted to over EUR 7 billion, had declined to EUR 5.7 billion in 2008.

Collective insurance

Besides voluntary individual pension insurance, such as annuity policies (the 'Third Pillar' of the Dutch pension system), life insurers also market employment-linked collective pension insurance (the 'Second Pillar'). The latter type of pension policy is called a 'direct scheme', a retirement pension agreement between an employer and a life insurer rather than a pension fund.[8] In addition, a pension fund may outsource (part of) its investment to an insurance company. This is done mainly by smaller funds that use outsourcing to reduce their administrative costs. In terms of gross premiums, insurers administered about 25% of all Second Pillar pension schemes in 2007 (for a comparison with other European countries, see the Box below – which discusses the Second and Third Pillars).

Premiums for collective pension insurance doubled between 1995 and 2008, to EUR 9 billion, in a mainly steady movement. Yet there were some pronounced peaks, caused partly by the discontinuation of large contracts with insurers or the movement of such contracts from one insurer to another. In this latter case all of a scheme's assets, accrued in years, are accounted for as a single premium deposit. In the early years of this period, back service liabilities in the pension scheme[9] could in some cases lead to hefty additional premium payments. The subsequent widespread shift towards more austere schemes, such as average pay-based schemes, has strongly reduced the need for these additional premium deposits. Premiums for *cash-based insurance* grew by EUR 1.9 billion between 1995 and 2008, to EUR 4.7 billion. Most of the premium increase occurred in the collective *unit-linked insurance* schemes, increasing the share of such schemes in total collective pension insurance policies to 49% (up from 38% in 1995). Until a few years ago, this shift was associated with a grown preference among workers for unit-linked schemes, which enabled them to profit from the stock price gains then prevailing. This preference could be exercised more easily than before, owing to a shift towards defined contribution schemes, where the risk of the investment, and thus of the benefit, is borne by the policyholder. Such options are not easy to change when stock market conditions deteriorate.

Asset accumulation

Through the year-on-year deposit of premium payments – EUR 26 billion in 2008 – private people, whether independently or through their employers, have built up claims on life insurance companies. For the insurers, these are liabilities showing up as technical provisions on their balance sheets, broken down according to who bears the risk, the insurer or the policyholder. This breakdown roughly corresponds to that between cash-based insurance and unit-linked insurance. To cover the liabilities, insurers invest in shares and, predominantly, bonds.

In 2008, the amount of technical provisions in respect of individual and collective insurance policies increased to a total of EUR 242 billion.[10] This is more than double the amount recorded in 1995, when this item stood at EUR 114 billion. The increase in absolute terms is split equally between provisions for cash-based and for unit-linked policies. Relatively speaking, however, the share of cash-based policies – the dominant type by tradition – declined from 81% in 1995 to 63% in 2008. Note, however, that the growth of provisions in respect of cash-based insurance mainly reflects the interest component: compounded interest on the net deposit is guaranteed. In the case of unit-linked policies, where the technical provision is merely the current value of the assets, the return on deposits was far more limited, owing primarily to poor stock market results after the turn of the millennium and, especially, in 2008 (when EUR 9 billion evaporated).

Just as for the insurer, technical provisions count as liabilities, for private policyholders they constitute (future) claims, to be converted into pension benefits and redemption of the policyholder's mortgage loan. They make up 20% of all bank balances, securities and claims on pension funds and insurers (see Chart 5).

Box

In other European countries, insurers are also active in the pension market, for both individual and collective schemes. Owing to population ageing, pension schemes are in strong demand everywhere. However, arrangements differ widely across countries. In most countries, the First Pillar (state pension) is the main component. In the Netherlands, the Second Pillar is relatively substantial. In 2005 the share of European insurers in the Second and Third Pillars (taken together for lack of more detailed data) was 64% (CEA Statistics No. 28, The role of insurance in the provision of pension revenue, September 2007). In the Netherlands, the share of insurers is lower (32%) owing to the predominance of pension funds (see Chart 4).

Chart 4 Share of insurers in Second and Third Pillar premiums

Per cent

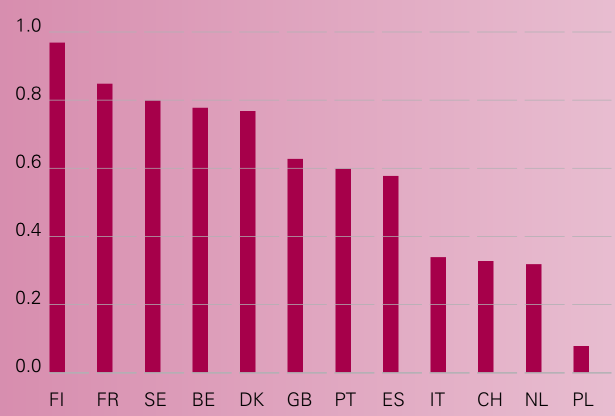
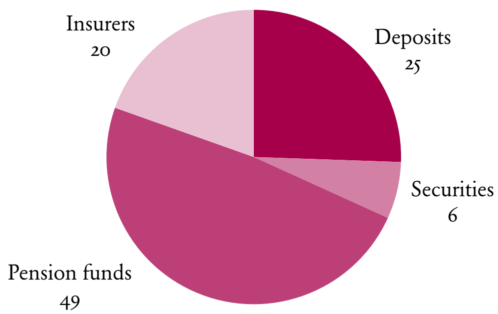


Chart 5 Breakdown of Dutch households' financial assets in 2008 (1,237 billion euros)
Per cent



Concluding remarks

Sales in the Dutch life insurance market has more or less stagnated for a number of years, despite increased demand for individual pension plans. This is caused by restrictions imposed on the tax benefit offered by annuity policies, on the one hand, and the introduction of tax-friendly bank savings on the other, which changed insurers' competitive relationship to the banks. Individual cash-based insurance policies have come under pressure, while once-strong demand for unit-linked insurance has dropped amid critical media coverage about transparency and costs. On the whole, poor stock market results did not do this product line much good either.

At the same time, the collective insurance market (the Second Pillar) shows better growth rates. Insurers cater to employers' need for pension schemes by offering tailored products. In addition, they offer possibilities for small pension funds wishing to outsource their investment.

1 Data taken from the annual insurance statements as reported to DNB by life insurers. Gross premiums exclude premiums in respect of indirect business (incoming reinsurance) and tontine plans (see also www.statistics.dnb.nl).
2 In 2008, gross premiums earned by non-life insurers (excluding premiums for basic health care insurance on account of their social insurance character) ran to EUR 22 billion. Basic health care insurance premiums, received by the health care insurers, totalled EUR 34 billion in 2008.
3 The analysis uses various insurance industry annual accounts prepared by the Verbond van Verzekeraars (Dutch Association of Insurers). For further reading, see Eggenkamp, M.G.H., *Levensverzekeringsmarkt verzadigd?* ('Is the life insurance market saturated?'), in Het Verzekerings-Archief, Vol. 2007, No. 4, pp. 151-153.
4 Data on new production were taken from the Productiestatistiek Levensverzekeringen ('Life insurance production statistics') of the Verbond van Verzekeraars (and for early years from several issues of the Statistical Bulletin of CBS (Statistics Netherlands)).
5 Verbond van Verzekeraars, Financieel Jaarverslag verzekeringsbranche (Annual financial report of the insurance industry) 2004, p. 20.
6 For the differences between such 'bank saving' and cash-based insurance, see Bikker, Jaap and Paul Schilp, Economisch Statistische Berichten, 25 January 2008, pp. 58-60. See also The Dutch Financial System, an Investigation of Current and Future Trends, DNB, July 2009, p. 33.
7 In the meantime, the main life insurers have agreed compensation arrangements with their clients.
8 See Life insurers: a hidden force in the Dutch pension system in the December 2006 Statistical Bulletin, pp. 25-35.
9 Increase of pension rights for past years of employment when pensionable earnings are increased.
10 Excluding reinsurance and tontine plans.

Monetary and financial statistics for the Netherlands

The tables listed below will no longer be published in the Statistical Bulletin as of this issue. Please follow the links to the tables on the DNB website (www.dnb.nl), where long time series in euro are published. Quarterly and monthly series generally start in 1982, daily series in 1990.

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