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A Brief History of the Institutional Design of Banking Supervision in the Netherlands

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* Views expressed are those of the individual authors and do not necessarily reflect official positions of De Nederlandsche Bank

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P.O. Box 98
1000 AB AMSTERDAM
The Netherlands

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Abstract

This paper describes how banking supervision in the Netherlands has evolved over time. It concentrates on how legal and institutional arrangements and the practice of banking regulation and supervision have responded to developments in the financial environment since the Bank Act of 1948 formally entrusted banking supervision to the Nederlandsche Bank. To put the developments of the last fifty years in a broader perspective, this study also contains a brief history of the Bank and the commercial banking industry in the Netherlands up to 1952. The paper concludes that the changes in financial supervision in the Netherlands have been inspired not by major banking crises, but by the evolving role of banks and by changes in the structure of the financial sector.

A Brief History of the Institutional Design of Banking Supervision in the Netherlands

by J. Mooij[#] and H.M. Prast^{*}

1 Introduction

This paper describes how banking supervision in the Netherlands has evolved over time. It concentrates on how legal and institutional arrangements and the practice of banking regulation and supervision have responded to developments in the financial environment. In 1952 a law was passed that provided the legal basis for the regulation and supervision of the banking sector by the Nederlandsche Bank (hereafter: the Bank). But prior to that, the Bank already carried out supervisory activities in an informal way. To put the developments of the last fifty years in a broader perspective, the paper therefore also contains a brief history of the Bank and the commercial banking industry in the Netherlands up to 1952.

The paper is structured as follows. The next section gives a brief overview of the early history of the banking sector in the Netherlands, from the establishment of the Bank in 1814 to the Bank Act of 1948, which formally entrusted banking supervision to the Bank. Section 3 describes the main features

[#] De Nederlandsche Bank, Research Department

^{*} De Nederlandsche Bank, Directorate Supervision, Section Banking and Supervisory Strategies

of the first Act on the Supervision on the Credit System of 1952. Section 4 discusses the Amendment of 1956 and the practice of supervision carried out until 1978. Section 5 examines the extension and revision of the Bank Act in 1978 and the practice of financial supervision until 1990. Section 6 studies the interaction between changes in the financial environment and in banking supervision and regulation in the Netherlands between 1990 and 2002. It includes the lifting of the prohibition of mergers between banks and insurance companies, the 1990 Protocol on the supervision of financial conglomerates, the new Act on Supervision of the Credit System introduced in 1993, and the developments resulting in the major change in the institutional design in the Netherlands in 2002, when the traditional model of sectoral supervision was replaced by a model of functional supervision, with a separation between prudential supervision on the one hand and conduct-of-business supervision on the other. The final section summarises the main conclusions.

2. *1814 – 1948: Paternal supervising*

The Bank was founded in 1814 on the initiative of King William I. Initially its purpose was to help revive the Dutch economy. Its first Charter makes no mention of its responsibility for monetary or financial stability. The Bank in those days can be characterised as a commercial bank, which was permitted to issue bank notes. During the first decades its activities – among which were discounting trade bills, lending against securities, trading precious metals – were limited in size. Furthermore, the public and the corporate sector did not have much confidence in the new bank notes. As long as there was no economic upswing, corporate sector demand for loans was small. The banks traded securities, and there were international lending activities as a remnant of the colonial past. What are nowadays called the traditional activities of banks – taking deposits and granting credit to private sector enterprises – were virtually absent in the Netherlands at that time. In fact, until 1860 the Bank was the largest commercial bank in the country (De Vries, 1989). During the second half of the nineteenth century the Netherlands saw a distinct economic recovery. From then onwards, the Dutch banking sector started growing and, by 1900, had taken over the Bank's leading position as measured by its balance sheets. Obviously, the banks were not the stimulus: it was a typical example of Joan Robinson's dictum "where output leads, finance follows" (Prast, 2001).

Based on the Bank Act of 1863, a nation-wide network of branches, or agencies, and correspondents of the Bank was established from 1864 onwards. Within a decade, the agencies in total attracted more business than the head office in Amsterdam. One of the activities of the agencies was discounting accommodation bills (*kredietpapier*). For this they needed a good knowledge of the customers, i.e. the corporate sector (Jonker 1996). When the private banking sector gradually took over the credit function of the Bank, this monitoring activity came to be concentrated on the newly founded commercial banks and mutual credit unions rather than on private sector entrepreneurs. With hindsight, these were the first, be it informal, supervisory activities undertaken by the Bank. An outstanding example of this are the ups and downs of the Zuid-Hollandsche Crediet-Vereeniging in the late

1880s. This mutual credit union was one of the largest clients of the Banks' agency at The Hague. Based on documents sent in every month, the Bank detected that the credit union's business policy was dangerous for its solvency. So it asked the managing board to change its policy. During the following course of events it became clear to the Bank that mismanagement and fraudulent behaviour had caused severe losses. In order to rescue this credit union, Bank president Pierson initiated a reorganisation and demanded the dismissal of the directors and the commissioners. Their successors were appointed only after Pierson had given consent. (Van Maarseveen, 1992, Kymmell, 1996).

The Bank Act adopted in 1903 confirmed that the Bank was allowed to act as bank of issue, and its banknotes were given the status of legal tender. No mention is made in this Bank Act of any responsibility for macroeconomic stability or of a supervisory function. And although the Bank was in fact the lender of last resort, this was not explicitly laid down in the law.¹ Supervision was realised through persuasion, as is clear from the terminology used at the time, 'paternal supervision' (De Vries, 1994). During the first decades of the twentieth century, the Bank gained importance as a banker's bank (Vanthoor, 1994). Its focus was on the creditworthiness of the banks as borrowers, not as key institutions in the system of payments and financial intermediation. However, as the Bank was advisor to the government it had, be it informally, a public duty, and De Vries (1992) stresses its role in those days as an 'economic watchtower'.

Meanwhile, the banking sector in the Netherlands showed a marked degree of expansion in the first decade of the twentieth century.² In this period, banks were growing both in size and in number: in the period 1894 – 1910 more than 100 new banks were established. New communication technology – telephony – enabled the banks to serve large areas, and business growth led to an increase in demand for larger funds. Not all new banks were successful, however: by 1913, 42 banks had disappeared, of which 38 through liquidation. Unfortunately, no further information about these bankruptcies is available. But the mere fact that this large number of banks was allowed to go bankrupt and, perhaps more importantly, that this did not lead to a financial crisis, is an indication of the relatively minor role of banks in the economy at that time. Insofar as the Bank felt responsible for both stability and efficiency of the banking system, it was not forced to choose between the two: the less efficient banks could be allowed to disappear without having to worry about systemic implications and financial panic.³

The outbreak of the First World War – the Netherlands remained neutral – led to a turbulent situation in the financial sector, but had no dramatic implications for the commercial banks in the Netherlands. One reason may be that deposit-taking was still limited in those days, hence bank fragility due to depositor panic was not as serious a problem as it would have been later. During the post-war years, the Dutch economy was booming and so was the profitability of banks. And when the boom turned into a recession, it became obvious that many banks

¹ However, this is not exceptional. As a rule, the lender of last resort function is not made explicit in Bank laws out of fear that the explicit mention of a safety net might induce moral hazard behaviour by banks. See Hartmann and Carletti (2002).

² Still, the banks did not stimulate the industrial revolution that took place around the turn of the century (Van Zanden and Griffiths, 1989; De Vries, 1994). Rather, they benefited from it. From 1880 through 1913, yearly average per capita growth in the Netherlands was 0.9 percent. This was low compared to economic growth in other European countries. De Vries (1994), Table 1.

had not diversified enough, concentrated too much on lending to industries that undertook war-related activities, and failed to screen their borrowers. Lack of experience and integrity added to these factors, as fraud played a role too. This was especially true of the smaller regional banks, although even the large Rotterdamsche Bank Vereeniging – or Robaver – one of the five largest banks, was suspected of irregularities. The result was a banking crisis. Between 1922 and 1927, 61 banks disappeared, of which 14 through bankruptcy.

During this crisis, the Bank developed as lender of last resort, giving liquidity support to individual banks. In the case of Robaver the Bank went even further, as it organised a consortium with the aim of supporting the price of Robaver stock by acting as a buyer on the Amsterdam Stock Exchange. The purpose of this action was the prevention of a bank run (De Vries, 1994). Apparently, the Robaver was considered ‘too big to fail’, although this terminology was not used at the time.⁴ Another example of a bank in distress was Marx & Co’s Bank, which was liquidated in 1922.⁵ The rescue attempt of this bank was, however, to be the last case of major emergency assistance by the Bank on the basis of private responsibility and the unwritten task of lender of last resort, that is before it was nationalised in 1948. In the case of the Amsterdam Bankassosiatie, which got into serious trouble in May 1922, a consortium was organised by other Amsterdam banks. This time the Bank displayed a different attitude. It was not only involved in organising the consortium, but also enforced a stringent regime of financial orthodoxy and supervised this closely. However, it did not give financial support.⁶ (De Vries, 1989; Jonker 1996) At that time, the Bank believed that preventive supervision of a credit institution which was not in need of constant credit support by the Bank, was out of the question. Its only instrument was to refuse to discount particular bills of exchange or to reject specific stocks as collateral. (Vanthoor, 2002)

One of the results of the banking crisis was that banks became reluctant – again – to finance the corporate sector, and their activities became concentrated on short-term credit against transferable collateral (Jonker, 1991). Although this flight to safety provoked a credit crunch and certainly did not mitigate the economic depression, it may have helped the banks to survive the macroeconomic crisis years: there was no serious financial distress during the 1930s. The fact that during the preceding financial crisis, the less healthy banks had disappeared, may also have been helpful. It was in these years that the role of banks in the Netherlands – as lenders to firms and as providers of the means of payment – became crucial to economic performance (Prast, 2001). Not only the banking sector faced a

³ Recent views stress, however, that there is hardly a trade off between efficiency and stability in the banking sector. See Hartmann and Carletti (2002)

⁴ The initiative for the rescue operation was taken by the government, which gave the Nederlandsche Bank a guarantee for an amount up to 60 bln guilders after Rabover’s top official had visited Prime Minister Colijn.

⁵ The liquidity support resulted in a loss to the Nederlandsche Bank of 26.9 bln guilders, the lion’s share of its total loss in connection with the banking crisis, which amounted to 31.1 bln guilders. It comes therefore as no surprise that the Bank was heavily criticised for its support, as Marx&Co’s doubtful position was common knowledge since 1916 (Jonker, 1991).

⁶ The Amsterdam Bankassosiatie was liquidated in 1937. Parts of it were taken over by the Incasso-Bank.

severe crisis in the 1920s. The insurance business, especially life insurance, faced a hard time too. Here the problems resulted in insurance supervision being formalised.⁷

Until the 1930s, the Bank's supervision activities had been of a parental and informal nature. Supervisory activities were carried out on an ad hoc basis and were aimed at isolated cases. In the 1930s however, the first signs of both monetary and prudential supervision – which at that time was called business supervision - appeared almost simultaneously. In the case of monetary supervision, this was a response to the suspension of the Gold Standard by the United Kingdom in 1931. In order to get information about the development of the balance of payments, the Bank requested the major commercial banks to send in monthly reports of their foreign assets and liabilities and of their gold reserves. This data flow was formalised by a Gentlemen's Agreement (1933-1937) between the Bank and over sixty banks. The latter agreed to support the guilder by, among other things, limiting the gold trade with the public. They also agreed not to act as counterparties in currency transactions against the guilder. Furthermore, they agreed to notify the Bank if they observed signs of any developments that might endanger the guilder. After the devaluation of the guilder the Agreement had lost its value and is ended at the initiative of the Bank. (De Vries 1994).

A first step towards prudential supervision was taken in 1932, when the Bank requested the banks to send in quarterly balance sheets. In this way it hoped to gain more insight into the development of the credit system. The reporting was intensified after the collapse of the internationally well-known banking house Mendelssohn & Co in Amsterdam. This bank had always submitted its quarterly reports, but now it had turned out that this kind of reporting was inadequate if international banking activities were involved. So the quarterly balances were replaced by monthly balances. The banks agreed that the monthly reports would be checked against the books of the banks by the auditors of the Nederlandsche Bank. At the Bank this agreement led to the establishment of an auditing department in the spring of 1940 (De Jong, 1960). Moreover, the banks agreed to inform the Bank about their outstanding loans over five percent of their own funds or above one million guilders. Both forms of

⁷ Partly due to the threat of war, the business of life insurance was booming. As a result, in 1919 the total sum insured by Dutch life insurance companies was 50 percent higher than in 1914. This post-war boom ended in an insurance crisis in the early 1920's. Two life insurance companies, the Algemeene Maatschappij van Levensverzekering en Lijfrente (General Life Insurance and Annuity Company) and Kromos, had to be liquidated as they no longer could meet their obligations. Decades before, policy makers already had agreed on the importance of a sound functioning of the insurance business to the economy. As goes for the banking industry, confidence is crucial for the well functioning of the insurance sector. Pleas by some politicians to nationalise the insurance sector did not gain general support. The crisis of the early 1920s, however, called for a legal provision for supervision of the insurance sector and speeded up the realisation of the Act on the Life Insurance Business. This Act provided for the foundation of the Verzekeringskamer (Insurance Board) in 1923. (De Wijs ed., 1998) In the beginning the execution of the Insurance Supervision covered only the life insurance companies and saving banks (spaarkassen). After the World War II, insurance supervision was extended to the building societies and various forms of pension funds and property insurance companies.

co-operation by the banks were voluntary. This approach would become a key issue in the future discussion about institutionalising supervision of the credit system.

Meanwhile, in 1934, Dutch parliament discussed the role of both the commercial banking sector and the Bank. This debate should be seen against the background of the financial sector's growing economic power and the bankruptcy of Mendelssohn & Co. This bank collapsed shortly after receiving a major loan from the Bank. For this reason, some contemporaries argued that the information was inadequate and did not enable the Bank to make a good judgement of the financial soundness of individual banks. (Bosman, 1958). With regard to the growing economic power of the financial sector it was said, with reference to the views in academic circles, that commercial banks have an important role to play in stabilising output and employment. At the time, pleas to nationalise the central bank did not win support however, but three years later, a parliamentary debate culminated in the establishment of the State Committee for the banking sector (De Jong, 1960; De Vries, 1994).⁸ Its task was to investigate the desirability of a legal provision for the supervision of the banking sector, and to assess whether the Statutes of the Bank should be changed. The Committee focused on four questions: is the functioning of the banking system adequate; what is the role of the banking system in the business cycle; are solvency and liquidity of commercial banks adequate; and what should be the relationship between the central bank and the commercial banks?⁹ The initiative for the State Committee is mainly to be seen as a response to the discussion about the independence of the Bank in respect of the revision of the Bank Act. An impulse was also given by the growing importance of the financial sector for the economy as a whole, as well as by the adoption of regulatory laws in the United States (Prast, 2001).¹⁰ Owing to the Second World War, the State Committee was unable to publish an official report. However, its discussions and preparatory work laid the foundation for the institutional structure of central banking and supervision in the Netherlands from 1948 onwards.

After the Second World War, the Dutch economy was in ruins. Minister of Finance Liefstinck took measures to end the highly explosive monetary situation. He announced a money purge in September 1945, which was successful (Barendregt and Visser, 1997). Another pressing post-war problem was the lack of foreign currency and gold. The country depended on the import of food to feed its impoverished population and on the import of raw materials and fuels to restore its almost collapsed national production system. The government imposed rules to control the allocation of the scarce currency and gold reserves to ensure that the sectors considered to be most vital for economic recovery would be supplied with the necessary financing. The Bank was in charge of the

⁸ According to De Vries (1994), the timing of the establishment of the Committee is surprising, given that the banks in the Netherlands had managed quite well during the recent depression years. It is likely that the developments in the academic world and in US legislation had their impact only with a lag.

⁹ Some members stressed the 'vocation' of the banking sector and its crucial role in macro-economic performance. Others argued that banks, if left to themselves, couldn't be expected to focus their strategy on the public interest

¹⁰ The Glass-Steagall Act of 1933, which created a separation between banking and securities activities, and the Regulation Q which forbade interest payments on deposits.

execution of the imposed regulation. It did not yet have a formal responsibility for banking regulation and supervision. Still, the emergency measures gave the Bank a firm grip on the post-war economy in general and the banking industry in particular.

Meanwhile, steps were taken to ensure that the Bank would receive the information it deemed necessary for its monetary objective. In early 1946 the Bank agreed with 42 commercial banks, and with the two central organisations of the agricultural banks, that they would send in figures on a monthly basis. This would enable the Bank to gain insight into the general course of banking developments.¹¹ The co-operation was formalised in a Gentlemen's Agreement. The Bank tested these credit activities against monetary standards only. Its control did not cover the solvency of the banks, but was purely motivated by monetary objectives. An example is the Bank's policy in the autumn of 1946. A rapid increase in bank credit alarmed the Bank, which was pursuing a strict monetary policy (DNB 1946, 1947). The post-war emergency measures gave the Bank the power to send a general warning to the Association of Commercial Banks requesting the banks to apply a strict standard in providing credit.¹²

3. The First Act on Supervision (1952)

In 1948, the Dutch Parliament adopted a new Bank Act, which implied nationalisation of the Bank. This Bank Act 1948 gave the Bank explicit responsibilities for both macroeconomic stability and the stability of the financial system.¹³ Yet, the supervision of the credit system was to be laid down in greater detail in a separate Act on the Supervision of the Credit System (*Wet Toezicht Kredietwezen*), which came into effect on 16 May 1952.¹⁴ In Parliament there had been a difference of opinion about whether or not supervision of the credit system ought to become permanent. The outcome of this debate was a compromise: the Act was given a temporary character and would expire on 1 January 1955. By then, however, the duration had been extended by two more years. Soon the Bill for a final settlement of banking supervision was submitted. This illustrates that in this brief period Dutch authorities had become aware of the need for banking supervision on a legal basis. Table 1 illustrates the landmarks in the history of Dutch supervision. It clearly shows how the pace of supervisory changes has accelerated over time, especially since 1990.

¹¹ In 1951 the number of financial institutions reporting monthly to the central bank had risen from 42 to 117 due to the increase of credit restrictions.

¹² This was laid down in article 19 of the so-termed Deblocking Decree 1945 together with General Licence No 40.

¹³ The tasks have been laid down in Section 9:

1. *It shall be the duty of the Bank to regulate the value of the Netherlands monetary unit in such a manner as will be most conducive to the nation's prosperity and welfare, and in so doing to keep the value as stable as possible.*
2. *It shall supply bank-notes for circulation in the Netherlands, and facilitate domestic and external money transfers*
3. *It shall supervise the credit system in pursuance of the Act on the Supervision of the Credit System*

(De Nederlandsche Bank, 1994)

¹⁴ Until 1952, the business of banking in the Netherlands could be conducted under commercial and civil law.

Table 1 Landmarks in the history of supervision

1814	Establishment of The Nederlandsche Bank
1948	Bank Act
1952	Act on the Supervision of the Credit System
1956	Amendment of the Act on the Supervision of the Credit System
1978	New Act on the Supervision of the Credit System
1990	Protocol on the Supervision of Financial Conglomerates
1992	New Act on the Supervision of the Credit System
1993	Revised Protocol on the Supervision of Financial Conglomerates
1994	Exchange Offices Act Unusual Transactions Act Amendment to 1992 Act with Regard to Supervision of Financial Conglomerates
1995	Amendment to 1992 Act with Regard to Deposit Insurance
1996	Amendment to 1992 Act Regarding Exchange of Information Between Supervisors
1998	New Bank Act with Respect to EMU
1999	Council of Financial Supervisors Amendment to 1992 Act with Respect to the Provision of Information to the Public
2002	New Institutional Structure of Financial Supervision Covenant Between Prudential and Conduct-of-business Supervisors

In the 1952 Act on Supervision a distinction was made between monetary supervision, aimed at supporting monetary policy, business supervision (which was to be called prudential supervision at a later stage, see section 5), aimed at safeguarding the interests of the creditors, and structural supervision, aimed at creating the conditions for a healthy and efficient banking sector (Klompé, 1992). The Bank itself was to decide how to act in case of conflicts between these goals. In 1949 the Bank had already started to exchange views on an informal basis with the banking sector. These regular meetings were given a legal basis by the 1952 Act. Still, the Act met with opposition from the banking sector, employers' organisations and politicians. The banking sector was offended by the fact that the Minister of Finance had not consulted them. Its criticism, which focused primarily on monetary supervision and to a lesser degree on business supervision, can be explained by unfamiliarity with the academic views on quantitative credit control as a means of monetary policy (Bosman, 1967).

Monetary supervision was based on the task entrusted to the Bank in section 9 of the Bank Act 1948, as described above. It was in fact closely related to post-war monetary policy. Monetary supervision will therefore only be discussed here indirectly and only insofar as it interfaced the business supervision as executed by the Bank since the Act on Supervision of the Credit System of 1952.

Supervision in general was based on the principle of consultation with the representative organisations.¹⁵ The Bank could not give a general instruction without consulting the representative organisations first. All 'general instructions, as well as the amendment, withdrawal and prolongation of the same', were subject to approval by the Crown.¹⁶ If no agreement could be reached or if individual institutions would not act in accordance with the

¹⁵ Nederlands Bankers' Association (Nederlandse Bankiersvereniging) was designated by the Minister of Finance as representative organisation of the commercial banks; the Co-operative Central Farmers' Credit Bank (Coöperatieve Centrale Raiffeisenbank) and the (Co-operative Central Agricultural Credit Bank (Coöperatieve Centrale Boerenleenbank) as the representative organisations agricultural credit banks; Netherlands Association of Savings Banks (Nederlandse Spaarbankbond) as the representative of the general savings banks.

¹⁶ Article 10.

agreed course of conduct, the Bank could issue general or special directives. The legislation largely reflected the practice of consultation that had been ‘en vogue’ ever since the days of paternal supervision.

During the first years, banking supervision was dominated by monetary supervision. In 1954, two arrangements were made to control the still distressed Dutch monetary situation. The first general directive imposed on the commercial banks and all agricultural credit institutions was a potential obligation to hold a monetary cover – in the form of liquid resources in proportion to deposits. This arrangement could come into effect whenever the Bank considered it to be necessary. This however never happened and therefore this arrangement came to be known as the ‘*IJskastregeling*’ (mothballed regulation).

The second general directive of 1954 provided for credit ceilings. The Bank came to a Gentlemen’s Agreement with the commercial and agricultural banks on cash reserve requirements. The banks agreed to hold cash reserves at the Bank if their deposits exceeded 10 million guilders. It was agreed that the required proportion would, as a rule, not exceed five percent, but if money market conditions should make it desirable, the percentage could, at the discretion of the Bank, be raised to ten.

As for business supervision, the 1952 Act on Supervision regulated the powers of the Bank in the field of control of the banking system. Subject to Bank supervision were: the commercial banks and central credit institutions, agricultural credit banks, general savings banks. A Royal Decree in 1954 stipulated that stockbrokers which made it their principal business to act as intermediaries in security dealings on the stock exchange and were also engaged in accepting money on deposit or in current account were to be treated as a separate section of securities credit institutions, and were hence under supervision by the Bank. Stockbrokers who did not meet these criteria were removed from the Register of credit institutions (hereafter the Register).¹⁷

As supervision of registered credit institutions was the core of the Act, much effort was put into making a register. Under the new Act, it became prohibited in the Netherlands to operate as a credit institution without a license by the Bank. In order to get a license, the commercial banks needed to fulfil minimum solvency requirements, with the required amount of own resources to be determined by the Minister of Finance.¹⁸ After formal approval by the Bank a credit institution was entered in the public Register. It should be stressed that at the time no requirements were introduced as to the professional abilities and integrity of high-level bank officials.

¹⁷ At the same time, the Minister of Finance designated the Stock Exchange Association (Vereniging voor De Effectenhandel) as the stockbrokers’ representative organisation in the field of credit.

¹⁸ The required amount could not exceed 100,000 guilders. Article 3.2 of the 1952 Act. As a transitory measure, it was laid down that commercial banks that did not possess the required minimum amount of own resources could be temporarily registered, but they had to meet the criterion within two years. This transitory measure was not included in the Amendment of 1956.

As for business supervision, the reporting by the credit institutions in order to monitor their solvency and liquidity was intensified in the 1950s. The process started with laying down lines for uniform annual and monthly statements. Between 1954 and 1956, the first directives containing provisions regarding liquidity and solvency were given to the registered banks. The 1952 Act gave the Bank the means to intervene in banking activities concerning the reduction of issued or paid-up capital, the permanent participation in, or taking over of, other credit institutions, the merger with other enterprises or institutions and financial reorganisation. In all these cases, a declaration of no objection by the Bank was required. Besides, the Bank could give credit institutions a notification if it detected signs of a development which it thought was or could jeopardise the solvency or liquidity of a particular bank. As a rule, neither the name of the financial institution concerned nor an indication of its actual financial situation was revealed. It was believed that supervision should not harm the market position of individual credit institutions.

In view of the special character of the agricultural credit banks and the savings banks the Bank made use of the legal provision to delegate the execution of business supervision in whole or in part to other organisations. Actually, the supervision of the liquidity and solvency of the member co-operative agricultural credit institutions was delegated to their two central organisations (see footnote 15).¹⁹ The business supervision of the independent registered saving banks was delegated to the Netherlands Association of Savings Banks.²⁰ In fact the most co-operative agricultural credit institutions and the savings banks had been subjected to supervision by their own central institutions for several decades (Bosman, 1958). All three of the above organisations had to carry out their prudential supervision tasks in accordance with the instructions of the Nederlandsche Bank.

4. The 1956-Amendment

Even though much value was attached to the voluntarily arrangements, it was decided that a legal structure of banking supervision was inevitable. The general feeling was that because of the large number of banks, it was almost impossible to rely on gentlemen's agreements only. (Bosman, 1958). So, based on the experiences of executing supervision, the original Act was amended and sent to Parliament. In fact, 1956 can be regarded as the final settlement of the 1952-Act. This time, the Minister of Finance had consulted the banking sector about the content of the amendment and the Bill passed through Parliament without any opposition. Subsequently, on 15 August 1956, the Amendment of the Act on the Supervision of the Credit System came into force. The revised Act strengthened the Bank's position as a supervisor of the credit system.²¹ Commercial banks which did not

¹⁹ Royal Decree, 28 October 1953, *Staatsblad*, No 486.

²⁰ Royal Decree, 30 August 1954, *Staatsblad*, No 390.

²¹ In the new Act some adjustments were made regarding stockbrokers. Originally they were defined as enterprises and institutions which operated mainly as intermediaries in connection with security dealings on the stock exchange. It had turned out that a large group of them neither granted credit nor accept deposits to a large extent. Since the scope of supervision was restricted to the credit system, the Bank no longer subjected stockbrokers not meeting the legal definition of security credit institution to supervision. The others, however, were now regarded as a separate collective subject to the Supervision Act, i.e. securities credit institutions.

possess the required minimum amount of resources determined by the Minister of Finance were no longer allowed to act as a credit institution. On the other hand, small banks were not forbidden, but were not subjected to supervision by the Bank either and hence did not require authorisation. This would become impossible under the 1978-Act.

In respect of monetary supervision, the original 1952-Act stipulated consultation between the Bank and the representative organisations before the former could give a directive. In the revised Act, this was only one phase in the process towards a directive. From now on it was stipulated that if no agreement was reached, the Bank could give a *general* directive which had to be submitted within three months to Parliament for consent. If agreement was reached, the Bank obtained the power to give *specific* directives to institutions that refused to follow the agreed course of conduct. As for business supervision, the general instructions on solvency and liquidity did get the status of guiding principles for the conduct of the credit institutions' business. If an institution did not comply, the Bank's only weapon was the procedure provided for in Article 17 of the Act on Supervision. This article enabled the supervisor to give an unwilling registered credit institution a notification. If necessary, this could be accompanied by an instruction and a specified statement of reasons. If the situation did not improve, the Bank's ultimate weapon was that of publishing the instruction and – at the credit institutions' request – at the same time publishing the correspondence between the Bank and credit institution regarding the given instruction. With this procedure, supervision had become more transparent in general, but remained confidential in every individual case .

Meanwhile, the financial landscape in the Netherlands was changing considerably. Unlike in Belgium and Germany, the links between industrial firms and the banking system were traditionally rather weak in the Netherlands. This pattern did not immediately change in the 1950s, when firms financed their expansion largely (for over 70%) with internal funds. But it did change dramatically in the 1960s. Corporate lending increased considerably thanks to economic growth. At the same time, demand for deposits boomed as a result of the increase in household wealth and the progress made in payment technology. An explosion of retail banking ensued. With an average yearly production growth of 8% during the period 1963-1973, the banking system grew more rapidly than any other sector (Van Zanden and Griffiths, 1989). This expansion was accompanied by concentration, most likely as a combined result of large-scale credit demand by the industrial sector, international competition, and the high cost of new technologies, which could only be borne by large-scale banks.

During the 1950s and 1960s, credit ceilings were an important instrument in creating monetary stability. By imposing quantitative limits on credit growth, the Bank intended to influence aggregate liquidity.²² In the 1950s and 1960s, the credit ceilings were repeatedly imposed with the aim of preventing liquidity from getting 'out of hand'. However, they clearly had the potential of distorting financial sector efficiency: Not only did the credit ceilings limit the growth of the banking sector as a whole, they also prevented individual banks from growing at an above-average speed, thus distorting competition. The Bank preferred credit ceilings over an indirect method

²² These ceilings were imposed on the credit granted by each individual bank during a certain month, calculated as a percentage of total credit granted during the twelve months preceding the restriction.

of credit control, as it feared that in the latter case competition would push interest rates up to unacceptably high levels. During the 1960s, the system of credit ceilings was criticised by the government because of its paralysing effect on the banking sector. In response to this criticism the system was adapted to make it more flexible, for example by allowing credit growth above the ceilings under certain conditions. However, the Nederlandsche Bank did not abolish it until March 1972.²³

Despite the limitations imposed on individual banks, the financial sector changed considerably during this period due to the two major mergers that resulted in the establishment of two large banks, ABN and Amro. In 1964 the ABN was created by a merger of Twentsche Bank and Nederlandsche Handel-Maatschappij and Amro bank by a merger of Amsterdamsche Bank and Rotterdamsche Bank. The announcement of the mergers took the Bank by surprise. Its responsibility for structural supervision had given the Bank the power to refuse a declaration of no-objection if in its opinion a merger would 'lead to an undesirable development of the credit system'. In their request for approval, the banks mentioned cost efficiency, adaptation to the growth of their clients and, last but not least, the need for the banking system to strengthen its position in the international financial playing field (Van der Werf, 1999). It was especially the latter argument that convinced the Bank that it could not refuse its approval, despite the risk that the new institutions would gain too much market power. With the take-over of HBU in 1968, the ABN gained access to Latin America and became the first 'global player' among the banks in the Netherlands.

The Bank faced a huge increase of applications for bank licenses in the 1960s, of which most had to do with mergers. Traditionally banks could be categorised by their specific activities, e.g. commercial banks, mortgage banks, savings banks, agricultural banks. By the 1970s this division gradually disappeared as banks started to expand their range of activities. The co-operative agricultural banks which were traditionally focused on financing agricultural activities had begun to diversify their banking activities in order to attract new clientele. In December 1972, finally, the two agricultural banking co-operations merged into RABO-bank.

Between 1954-1966 the Bank had given a total of 34 cautionary recommendations to credit institutions after having detected signs of a development which, in its opinion endangered or might endanger the solvency or liquidity of a particular credit institution. This is what happened in 1966 with Gebr. Teixeira de Mattos, a small bank with a few large and many small depositors. Due to a mismatch in its credit policy, the bank got into trouble. After several warnings by the Bank, the sole proprietor started to manipulate the monthly statements and to cook the balance sheets. By doing so, he gave a false impression of the bank's liquidity and solvency. In the end, suspension of payment and publication were inescapable. It subsequently appeared that the bank had misled the Bank, which had no instruments to prevent this kind of deceptive conduct.(Fase, 2000) This incident got much attention in the newspapers during the summer of 1966. One of the reasons was that many small depositors suffered financial consequences because of this bank failure. Another reason was the general belief, at that time, that banking supervision could and indeed should prevent bank failures.

²³ In 1977 credit ceilings were reinstalled. Hilbers and Hoogduin (1996) give an overview of post-war instruments of credit control in the Netherlands.

The Teixeira incident led to parliamentary questions to the Minister of Finance about the role of the Dutch central bank. The Minister replied that the Bank had warned Teixeira more than once. He also stressed that legislation could never prevent false representation, nor guarantee that problems would be brought into the open in time for creditors to take action. Nevertheless, this bankruptcy would influence the future Act on Supervision, which was already in preparation, although it would take more than twelve years before it was passed. The protection of the interests of depositors was to receive more attention. Furthermore, emergency regulations were to be introduced.

The main characteristic of business supervision up to the 1970s was that, in essence, it was based on the figures submitted by the registered banks. Furthermore, up to then each of the four categories of credit institutions, viz. commercial banks, agricultural banks, securities credit institutions and general savings banks, faced their own set of directives. The need to change this was already felt in the late 1960s as a result of the changing financial environment. It was one of the main reasons for revising the 1956 Act on Supervision, a process which started in 1965. Another reason for revision was the tendency to harmonise business supervision according to EC-regulations. It would, however, take until 1979 before the new Act came into force.

5. The 1978 Act

With the 1978 Act, the emphasis of banking supervision shifted from monetary towards prudential supervision. The collapse of the Bretton Woods system in 1973, and the liberalisation of international capital markets that would take place in later years, implied that monetary policy would ultimately become directed at pegging the exchange rate of the guilder to the Deutsche Mark (De Greef et al. 1998). At the same time, the growing importance of the banking sector called for more detailed prudential supervision. For that matter, banking supervision in some European Economic Community-countries was studied at the Bank. Special attention was paid to elements like deposit insurance, business licensing conditions, security funds and solvency requirements. Later on, the US system of deposit insurance was examined as well.²⁴ Another aspect of consideration were mergers. In most other countries, regulations on mergers existed at that time. In 1964, confronted with the mergers of four large banks, the Bank had stipulated as a condition, that it would judge every participation of 5 percent or more on its admissibility. Ways of incorporating this in new legislation were now explored. The revision of the Act as well as the process of consultation was finished by the end of 1970.

²⁴ Deposit insurance was introduced in the US in 1934, after the country had faced a banking crisis in the years before. However, it is of much earlier origin, according to C.W. Calomiris and E.N. White (2000)

In addition, the Bill for revised supervision of the credit system together with an Explanatory Memorandum was sent to Parliament. Due to a lengthy and rather complicated decision process, the new Act on Supervision did not enter into force until 1 January 1979, together with a number of decrees and orders for its implementation.²⁵ At first glance it is perhaps surprising that it took such a long time. However, during the entire process the Bill was adjusted to the latest developments, keeping it up to date. So, the Act on Supervision of 1978 met the first EEC-directive with regard to the co-ordination of banking legislation. (DNB, 1979)

In the Act on Supervision of 1978, the expression prudential control replaced the old expression of 'business supervision' or 'supervision over solvency and liquidity'. Apart from this modernisation, the former three directions under which supervision on the credit system was carried out remained the same. Now they were referred to as monetary supervision, prudential control and structural supervision. On the whole, the Act on Supervision was broader, more detailed and provided the Bank with more instruments. It reflected a firmer grip on the business of banking in the Netherlands. In general it broadened the scope of supervision. The definition of credit institutions was widened to embrace all credit institutions which made their business of receiving funds repayable at less than two years' notice, and of granting credits and making investments on their own account. Additionally, supervision was extended to other categories of institutions like capital market institutions and near-banks. So industrial and non-banking enterprises which contributed to liquidity creation were subjected to monetary supervision. From then on supervision also included mortgage banks,²⁶ Bank for Netherlands Municipalities (Bank voor Nederlandsche Gemeenten NV), the National Investment Bank (De Nationale Investerings Bank NV²⁷) and the Postal Cheque and Giro Services (Postcheque- en Girodienst) as well as the Post Office Savings Bank (Rijkspostspaarbank).

As to monetary supervision, the old instruments based on the Exchange Control Decree were now incorporated in the new Act. The possibility of imposing regulations on the net external position of banks became one of the two 'structural' instruments of the 1978-Act. Furthermore, the Bank could prescribe a structural cash reserve in proportion to the liabilities of the financial institutions.

One of the most fundamental changes was the introduction of a system with license requirements. Among other things, it was laid down that the day-to-day policy should be determined by at least two persons, that a credit institution which is a public company or private company with limited liability

²⁵ In June 1975 the Minister of Finance submitted his Memorandum in Reply (Memorie van Antwoord) accompanied by a revised Bill to Parliament. This enabled the Standing Committee on Finance of the Second Chamber of Parliament to resume discussion of the Bill, after an interval of more than four years since the Interim Report of April 1971. After some alterations, Parliamentary debate took place in February 1977. That same month the further amended Bill was presented to the First Chamber of Parliament. When the Government resigned, discussions were postponed. After the new Government took office the Standing Committee on Finance of the First Chamber handed over its Interim Report in January 1978. (DNB, 1975-1978)

²⁶ By Decree of the Minister of Finance of 29 December 1978, the Netherlands Association of Mortgage Banks (Nederlandse Vereniging van Hypotheekbanken) was designated as representative organisation of the mortgage banks.

²⁷ As a result of business developments The National Investment Bank was registered as a universal bank from 1 January 1988. (Coljé, 1988)

should have a supervisory board of at least three members, that credit institutions should have a certain minimum amount of available own resources and that each credit institution should submit its annual accounts – balance sheet and the profit and loss account – accompanied by an explanatory report and certified by a registered accountant to the Bank in accordance with the model laid down by the Bank, within six months of the end of the year.

Other novelties were the prerequisites on expert knowledge of one or more persons who determine the day-to-day policy of the credit institution and on the reliability of the persons who determine or co-determine the policy of the credit institution. If the Bank considered them inadequate or was of the opinion that the interests of the creditors might be seriously at risk, it could refuse to grant a license. Furthermore, these conditions applied to both new institutions and existing ones. A license could be revoked if a credit institution no longer fulfilled the requirements. Under the 1978-Act a company without a license was not allowed to act as a financial institution and legally no longer allowed to call itself a 'bank' from 1 January 1980. Under the old Act, the Bank had no legal means to interfere if a financial institution did not meet the required criteria for a license. In addition, the Bank acquired the power to request suspension of payment for investigated non-registered institutions. This could be used if the Bank, having made inquiries based on the 1978-Act, had the impression that such an institution was unable to continue paying its due debts.

As for structural supervision, the 1978-Act stated that a declaration of no objection was needed for, among other things, participation (over five percent) in non-credit institutions and the exercise of voting rights in respect of shareholdings of more than five percent in credit institutions. The Act did not allow credit institutions to merge with other enterprises or institutions. The rationale was to prevent concentration of power or developments which might be against the general interest.

As far as protecting the interests of creditors was concerned, the new Act introduced deposit insurance and emergency regulations. The main objective of deposit insurance – which guarantees bank depositors a repayment of their deposits, usually up to a maximum amount – is, that it prevents bank panic and runs on healthy banks, as these runs would lead to illiquidity followed by insolvency.²⁸ If a registered credit institution went bankrupt or was in need of provisions, the newly introduced Implementing Body (Uitvoerend Orgaan) would pay a fixed amount to each affected creditor as soon as possible.²⁹ In doing so, the Implementing Body took over the creditors' claims on the credit

²⁸ By Royal Decree of 29 June 1978 the Bank was authorised to perform the required activities in connection with the administration of the collective guarantee scheme referred to in section 44, 1 of the Act on Supervision of 1978. In the USA during the Great Depression, deposit insurance was introduced to prevent bank runs. Although this may have contributed to preventing bank runs, it may also have created moral hazard behaviour on the part of the insured institutions. In 1980s the large number of bankruptcies and the resulting deficits in the guarantee fund gave rise to a discussion about the pros and cons of deposit insurance. As for the Netherlands, there is no guarantee fund. Bikker and Prast (2001) give a survey of the discussion in the Netherlands.

²⁹ The maximum amount was index-linked and would be revised every three years.

institution. It was laid down that the Bank would act as the Implementing Body and was to be assisted by an Advisory Body.³⁰

As said before, emergency regulations were introduced. They were designed for situations when the solvency or liquidity of a credit institution shows signs of a dangerous trend and no improvement in this trend can reasonably be expected. In those cases the Court could, at the Bank's request, declare 'the credit institution to be in a position requiring special measures in the interest of all creditors' (section 31 and 32). Under the new Act on Supervision, legal provisions regarding the suspension of payment were not applicable to credit institutions.

With the new Act that came into force in January 1979, the Bank had become the supervisor of mortgage banks in the interest of their solvency and liquidity, a sector which thus far had been, like the savings banks and the agricultural credit banks, characterised by self-regulation. Credit institutions were granted a period of three years in which to adapt their organisation and operations to the new legislation. But shortly after the introduction of the new Act, the mortgage banking sector was confronted with serious difficulties, partly as a result of macroeconomic developments. The 1970s had been a period of double-digit inflation and high nominal interest rates. Real rates were low and this elicited a boom in the real estate market. By the end of the decade this bubble burst. Inflation fell, real rates rose and the real estate market in the Netherlands collapsed. Banks with large mortgage portfolios experienced serious difficulties. In fact, in 1982 the Tilburgsche Hypotheek Bank (Tilburgh Mortgage Bank) went bankrupt as a result of serious losses on its debt portfolio. These were for a large part related to developments in the commercial real estate market. It should also be kept in mind that the difficulties arose at a time when not all the changes for adapting to the new Act had been made. Thus, Tilburgh Mortgage Bank had not yet applied the 'four-eyes-principle'. It became the first bank to which the 'emergency regulation', introduced with the 1978 Act and described in the previous section, was applied. During the period preceding the collapse, an attempt was made to rescue this mortgage bank. Three other large mortgage banks did, in co-ordination with the Bank, try to prevent the failure by granting subordinated debt, but this attempt was unsuccessful. Two other regional mortgage banks, Westland-Utrecht Hypotheekbank and Friesch-Groningsche Hypotheekbank, got into difficulties as well. However, they survived with the help of two major insurance companies, Nationale Nederlanden and Aegon. This operation was facilitated by the statement by the Minister of Finance in 1981, that if banks and insurance companies wished to increase the solvency of mortgage banks, a declaration of no objection under article 25 of the Supervision Act would not be automatically refused. With hindsight, the Minister's statement can be seen as a first step towards the lifting of the prohibition on cross-sector mergers that was to take place in 1990 .

³⁰ By Royal Decree of 21 December 1978 the Nederlandsche Bank was authorised to act as such. The six members of the latter were appointed by the representative organisations.

6. The 1990s: towards a new structure of financial supervision

The final decades of the twentieth century saw a distinct change in the financial landscape in the Netherlands. Globalisation, conglomeration, the blurring of distinctions between banking, insurance and securities activities, the single market for financial services in the European Union, the birth of the Euro and a growing awareness of the importance of financial integrity and consumer protection were challenging regulatory and supervisory policy and affected the institutional structure of financial supervision in the Netherlands in various ways. This section will describe the interplay between these trends and banking supervision. The changing financial environment did call for closer co-operation between the different financial supervisors within the Netherlands and it implied that banking regulation would become subject to international agreements.

The liberalisation of capital markets in the 1980s legalised cross-border activities for financial institutions. The subsequent developments in information and communication technology made these activities economically profitable. In order to be successful players in a global financial market, the banks in the Netherlands had to grow. The lifting in 1990 of the prohibition on combining banking and insurance activities in one financial institution, helped them by paving the way for mergers between banks and insurance companies into large financial conglomerates. Immediately after the lifting, a process of mergers and acquisitions ensued (Van der Zwet, 1999). In fact, the Netherlands was one of the pioneers in the area of 'bancassurance'. By 2000, ten of the fifteen largest banks in the Netherlands had become part of a financial conglomerate. Growth was not only realised cross-sector but also cross-border (Fortis), and by expanding international activities, as ABN Amro did in the United States.

The lifting of the prohibition on combining banking and insurance activities was an important change in structural supervision. It also marked the beginning of a process of co-operation between the financial supervision authorities in the Netherlands. The emergence of financial conglomerates called for co-ordination between the banking and insurance authorities. In 1990 the Bank and the insurance supervisor (Verzekeringkamer) concluded a Protocol in order to ensure adequate supervision of financial conglomerates. The basic idea of the Protocol was that the banking and insurance branches of a financial conglomerate are each supervised by their respective authorities. The Protocol established rules for the conditions to be fulfilled by conglomerates in order to be granted an authorisation and obliged the supervisors to exchange information. Depending on whether the conglomerate is primarily engaged in banking or in insurance, it was to be the banking or the insurance supervisor, respectively, that decides upon the solvency requirements at the holding company level, but the holding company must inform both supervisors about its solvency on a consolidated basis.³¹ In response to the rapid developments in the creation of financial conglomerates, the new Act on the Supervision of the Credit System in 1992, and an evaluation of the 1990 Protocol, the latter was revised and given a legal basis in 1994.

Meanwhile, the internationalisation trend had prompted supervisors world-wide to intensify their contacts and co-operation. This implied that, although banking supervision remained a national responsibility, banking supervision in the Netherlands became more and more constrained by international agreements and regulations. As a rule, the international agreements provided minimum standards and left further regulation at the discretion

of national supervisors. Some agreements were to cover the European Union (EU), others applied to industrialised countries world-wide. An example of the latter is the Basle Capital Accord of 1988, which established common international minimum solvency standards for banks. It was drawn up by the Basle Committee on Banking Supervision, which consists of representatives of the banking supervisors and central banks of the Group-of-Ten countries (plus Switzerland, Luxembourg and Spain since 2001).³² The Basle Accord was inspired by the desire to create an international level playing field for banks. As far as the EU is concerned, the creation of the single market for financial services in 1992 was an important step forward in the financial integration in Europe. Banks, insurance firms and investment firms authorised by one Member State of the EU are allowed to establish branches or provide cross-border services in other Member States. Within this single market, supervision is the responsibility of national authorities and it is thus the home country authority that supervises cross-border activities. The single market policy, based as it is on mutual recognition of national regulations, requires a considerable degree of harmonisation of financial regulation. The harmonised directives are important instruments in this respect. They are legally binding and are designed to prevent regulatory arbitrage and to create a level playing field. The legislation in the EU obliges the supervisors to co-operate with each other and to exchange information. One way that this co-operation takes shape is through a web of consultative and decision-making bodies, such as the Banking Supervision Committee, the Groupe de Contact and the Banking Advisory Committee. Further co-operation is reflected in, mostly bilateral, Memoranda of Understanding between Member States.

In 1992 a new Act on the Supervision of the Credit System was drawn up in order to adapt national legislation to the demands of the single market for financial services in the EU. Since the late 1980s, various EU-Directives had indicated how Dutch legislation relating to diverse banking activities and (prudential) supervision should be modelled. As far as prudential supervision was concerned, they were largely based on recommendations by the Basle Committee on Banking Supervision. The 1992-Act legalised the principle of home country control. It also widened supervision to the administrative organisation of credit institutions. From now on, recommendations and general directives could be given concerning the way credit institutions are conducting their business. An additional adjustment to the Act was made in July 1995 when the Deposit Insurance Scheme had to be revised according to the EC directive on this matter of May 1994.

During this decade, financial integrity became an increasingly important issue in the discussion about financial market regulation and supervision. For that matter, the authorisation requirements were sharpened. As to the prerequisites on expert knowledge of persons who determine the day-to-day policy of the credit institution and on the trustworthiness of the persons who (co-) determine this policy the Act was far more detailed. It was stipulated that the Bank shall authorise unless (among other things) it is of the opinion that the expertise of persons who determine the day-to-day policy 'is insufficient in connection with the pursuit of the business of a credit institution' and 'in view of the

³¹ In 1992 the Insurance Board was separated from the Ministry of Finance and became an independent public institution.

³² The Basle Committee was established in 1975 at the initiative of the central bank governors of the G-10 countries in response to the well-known Herstatt-crisis, which made clear the need for information exchange and co-ordination between national banking supervisors.

interests of the creditors of future creditors of the enterprise or institution, the trustworthiness of one or more persons who determine or co-determine the policy of the enterprise or institution, is not beyond doubt'. The expertise is tested prior to the appointment on the grounds of education, professional experience and references. The trustworthiness is tested both on the basis of the references given and on the information available to the Bank or other supervisors in the financial sector. In addition, police records may be consulted. Furthermore, on applying for authorisation the applicant should give detailed information about the number, the names and the past history of the persons who determine the day-to-day policy of the institution.

Since 1992, the Act on Supervision and the rules based on it have been adjusted several times. This is an ongoing process. The Act has been amended as a result of regulations concerning the supervision of financial conglomerates (1994), the exchange of information with other supervisory authorities (1996), and the provision of information to the public (1999). During this decade, financial supervision was broadened, as more financial intermediaries were brought under supervision regarding their conduct of business. In 1994 two new, separate Acts entered into force, the Unusual Transactions Notification Act and the Identification Financial Services Act, aimed at preventing the financial system from being used for money laundering. This was followed by the Exchange Offices Act, which entered into force on 1 January 1995. From now on exchange offices had to be registered by the Bank and were subject to prudential supervision.

In view of the establishment of the Economic and Monetary Union and the single currency on January 1, 1999, a new Bank Act was adopted in the Netherlands in 1998. With this Act, the right for the government to give directives to the Bank was abolished, making the Bank independent with regard to monetary policy. The supervisory task is laid down in Section 4 of the Act, which states that: 'The Bank shall have the task of supervising financial institutions in pursuance of the relevant statutory regulation.' The same section (4.2) gave the Bank for the first time the explicit task of '.... promoting the smooth operation of the payment system'. The establishment of the European Central Bank (ECB) implied that emergency liquidity support by the Bank should not interfere with monetary policy by the ECB. To the extent that this support would have an overall effect that would be relevant for monetary policy or have a financial stability implication for the Euro area, the Eurosystem would be actively involved. However, the lender-of-last-resort function is not explicitly defined, as maintaining "constructive ambiguity" may help to reduce the moral hazard associated with a safety net (Padoa-Schioppa, 1999). As far as banking supervision is concerned, the Maastricht Treaty gives the Eurosystem the task to "contribute to the smooth conduct of policies pursued by competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system" (Maastricht Treaty 1992, Article 105 (5)), while keeping the primary responsibilities in these areas at the national level.

Over time, it became clear that the blurring of distinctions between banking, insurance and securities activities in the Netherlands called for a further reflection on the optimal institutional structure of supervision. This need was

not only evidenced by mergers and acquisitions and therefore the birth of financial conglomerates, but also by the characteristics of the new, increasingly complicated financial products.

In some countries, developments in the financial environment had prompted the authorities to create a single supervisor for the various financial sectors (Lannoo, 2000). In those countries the reorganisation was sometimes triggered by bank failures and the ensuing discussion about the question whether supervision and regulation were adequately designed. Initially, the Netherlands did preserve the existing institutional set-up, with regulation and supervision of the banking system entrusted to the central bank, and with insurance and securities firms having separate supervisors. The choice in the Netherlands to maintain a structure in which the central bank is responsible for the prudential supervision of banks has to do with stability considerations. In view of the high degree of concentration of the banking sector systemic and prudential supervision are appropriately placed close at hand of the central bank (Brouwer, 2002).

Still, the blurring of distinctions between different types of financial firms and products called for more co-operation between the three supervisors. In 1999 a council of the banking, insurance and securities supervisors was established.³³ The aim of this Council of Financial Supervisors (Raad Financiële Toezichthouders) was to give an additional impulse to cross-sector co-operation between the financial supervisors. The Council is not a decision-making body on supervisory and regulatory issues, but should be viewed as a forum for discussion and further co-operation in the field of cross-sector regulatory and supervisory issues. One of the prominent issues on the agenda of the Council was financial integrity and consumer protection. As more small amateur investors entered the markets and increasingly complicated financial products became available, the protection of consumers of financial products became more important. Also, society became increasingly aware of the potential adverse effects of a lack of integrity in financial markets. The Bank and the securities and insurance supervisors, for example, recognised the need for regulation of the quality of the information offered by suppliers of financial products. Their co-operation resulted in the requirement, as of 1 July 2002, that financial products be accompanied by standardised minimum information about their key features.

In 2001, in anticipation of the reorganisation of supervision that was to take place in 2002, the Bank and the Pensions and Insurance Supervisory Authority established close links between their Boards of Directors, with cross-board appointments at executive and non-executive levels. In 2002, a major change took place in the institutional structure of financial supervision in the Netherlands. In the new model, financial supervision is organised not by industry, with each sector having its own supervisor,

³³ As for the securities industry, the sector itself (Amsterdam Exchanges and the Options Exchange) had established its own Authority (Stichting Toezicht Effectenverkeer (STE)) in 1988. This self-regulation was gradually transformed, between 1988 and 1997, into a public institution (though financed by the sector and not through public funding). This transformation was motivated by a growing awareness of the importance of integrity in financial markets, by suspicions about insider trading, and by international competition and regulation abroad. At a later stage, the STE would become responsible for conduct-of-business supervision of the financial sector .

but on a cross-sector basis in line with its main objectives: systemic stability, prudential supervision and conduct-of-business supervision.

The reorganisation of the model of financial supervision is based on the philosophy that financial supervision should meet three criteria. It should be effective, market-oriented and efficient. Effectiveness implies that supervision should meet the objectives of systemic supervision, soundness of financial institutions and proper conduct of business, including market transparency. Market-oriented implies that markets should be as undistorted as possible, and that institutions can compete in a level-playing field. Efficiency requires that the overlap between the tasks of the different supervisors should be kept to a minimum and that the administrative burden of the supervised institutions should be restricted.

In the new set-up, the Bank remains responsible for systemic stability. The responsibility for prudential supervision is taken care of by both the Bank and the Pensions and Insurance Supervisory Authority. They co-operate with joint teams for prudential supervision of financial conglomerates. As a separate supervisor, the STE, which changed its name to the Netherlands Authority for Financial Markets (Autoriteit Financiële Markten) is responsible for conduct-of-business supervision on a cross-sector basis. It should be stressed that despite the institutional separation, co-operation between the prudential supervisors on the one hand and the conduct-of-business-supervisor on the other is important, as some issues, for example financial integrity, have both prudential and conduct-of-business dimensions. Thus, the Council of Financial Supervisors will remain as a consultative platform for common issues. A Covenant between the three supervisors, which entered into force in September 2002, establishes further rules for their co-operation and co-ordination, within the legal framework (De Nederlandsche Bank et al., 2002). Thus, the Bank and the Pensions and Insurance Supervisory Authority are jointly responsible for authorisations to banks and insurance companies, whereas the Authority for Financial Markets holds this responsibility with regard to securities.

7. Conclusion

The role of the Bank as an informal financial supervisor can be traced back to the nineteenth century. Since 1814, when the Bank was established, it has evolved from a privately owned commercial bank into a central bank responsible for monetary policy, prudential supervision and systemic stability. The increasing importance of banks for the economy and the changing views on the role of the state in the Interbellum led to the nationalisation of the Bank in 1948 and to the adoption of the 1952 Act on the Supervision of the Credit System. Since the adoption of the latter, the financial environment in which the Bank operates has changed considerably. This influenced the way banking supervision was formalised. The first Act still reflects the old spirit of gentlemen's agreements. Later amendments and new Acts provided for more codification and, as time went on, for more detailed formalisation.

In the 1950s and 1960s the focus of banking supervision in the Netherlands was on monetary supervision. This changed with the liberalisation of capital markets and with the shift in monetary policy. From the late 1970s, prudential supervision and consumer protection became more significant,

and from the 1990s financial integrity and conduct-of-business supervision gained importance. Over time, supervision was broadened firstly because more institutions were brought under the definition of credit institution, and hence became subject to solvency and liquidity requirements, and secondly, because conduct-of-business supervision was applied not only to credit institutions but also to other financial intermediaries.

Over the past fifty years, the pace at which supervision in the Netherlands changed has increased considerably. The 1956 Act on the Supervision of the Credit System survived for 22 years, its 1978-successor for 14 years, and since 1990 there has been a rapid succession of major changes, both in the legal framework and in the institutional structure of supervision. The changes in financial supervision in the Netherlands have been inspired not by major banking crises, but by the evolving role of banks and by changes in the structure of the financial sector. The cross-sector basis of the new model of financial supervision clearly reflects the continuing integration of financial institutions in the Netherlands and is therefore expected to provide a solid supervisory structure for the future.

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