The Dutch Financial System

An Investigation of Current and Future Trends

De Nederlandsche Bank
Eurosysteem

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An Investigation of Current and Future Trends

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Introduction

Since its inception almost exactly two years ago, the current financial crisis has grown to be the most disruptive in a generation. The speed at which it spread from a relatively small financial market to large parts of the global financial system and the real economy has surprised many investors, academics and policymakers. Far-reaching interventions by authorities were required to contain pressures on the financial systems of many countries.

These events have left the financial landscape in a state of change. Financial trends that were relatively predictable in the pre-crisis decade have often been reversed. In addition, the macro-economic outlook has turned significantly and the regulatory response to the crisis will likely alter the environment for most financial institutions. These turbulent circumstances are expected to lead to increased strategic repositioning of Dutch financial institutions. Given its combined responsibility for the soundness of individual institutions and financial stability, DNB considers it important to be well-prepared for this increased activity. In the first quarter of this year, DNB therefore started this project, which aims to give a fact-based survey of post-crisis developments that are relevant for Dutch financial institutions. The focus is not on different types of financial institutions as such, but on the various business lines within financial institutions, such as retail banking, investment banking, life and non-life insurance and asset management. This increased granularity provides better depth of insight, since financial institutions are typically organized along the various business lines.

The project was overseen by a Steering Committee consisting of representatives of DNB as well as a representative of the Dutch Ministry of Finance. An external consultant provided support in the form of fact finding and data analyses. As part of the project, interviews were held with senior executives and other stakeholders in the Dutch financial sector. DNB would like to thank these interviewees for their useful contribution. The 'Kabinetsvisie toekomst financiële sector', which describes the policy actions of the Dutch government with respect to the financial sector, is published on the same date.

Chapter 1 presents possible economic and regulatory scenarios. Chapter 2 takes stock of trends and other key issues facing the various business lines as well as combinations of business lines, with specific attention for the position of Dutch players. Chapter 3 explores opportunities and threats facing the Dutch financial sector.

Executive Summary

The uncertainties that financial institutions face in the next five years are considerable. In light of these uncertainties, scenario analysis has been used in assessing trends and other key issues in the various (combinations of) business lines. The first scenario is U-shaped, and is characterized by intensified international cooperation and a relatively fast economic recovery. The second scenario is L-shaped, with decreased international cooperation and a prolonged recession. The following sets out trends and other key issues per business line.

While fairly concentrated,[1] the Dutch *retail banking* market is also fairly competitive, with both lower cost and lower revenue margins than the European average. Although in most European countries revenues generated on current accounts compensate for losses incurred by maintaining payment systems, this is not the case in the Netherlands, where it remains loss making. Multi-channel distribution has contributed to increased switching, which, in turn, has been amplified by the loss of trust caused by the crisis, so that 'switching' has evolved into 'spreading'. In this respect, it should be noted that current competition in retail banking is disturbed by deposit guarantee schemes (DGS), with an increased limit of EUR 100,000 in Europe. In addition, reduced demand for important retail products (consumer finance and mortgages) in the coming years and potential losses in mortgage lending portfolios could further negatively impact profit levels in retail banking. Revenue improvements and cost reductions may be necessary to salvage profitability; costs could be reduced through improved operational efficiency and non-performing loans management, whereas revenues could be increased by improving customer satisfaction and introducing fair charges for payments, among other factors.

Despite recent changes in ownership of the Dutch banking sector, both Dutch mid- and large corporates are still believed to have sufficient access to *corporate and investment banking* products to serve their domestic needs; large corporates appear to be increasingly served by foreign banks, both for domestic and foreign needs. Given the increased international competition, Dutch corporate banks will need to maintain an (internationally) competitive product palette to ensure profitability over time. The concentration of banks servicing the mid-corporate segment, a group largely reliant on national banks, has increased. At the same time, mid-corporate access to banks with an international branch network has decreased; the required divestment of a portion of ABN AMRO's Dutch banking network by the European Commission could provide mid-corporates more choice of banks. The Dutch corporate banking sector probably will have to scale up non-performing loan warning systems and work out capabilities and capacity in light of the current crisis.

Revenues and profitability in the *life insurance* sector are expected to be under pressure from general economic and sector specific developments. In an L-shaped scenario, lower interest rates and corporate bond defaults would likely have a detrimental effect on the in-force business. Furthermore, low interest rates could undermine the sale of new guaranteed products, while depressed equity markets could further decrease appetite for unit-linked products. All these effects would be less severe in a U-shaped scenario. Irrespective of the scenario, Dutch insurers are also likely to face a negative impact on revenues (and profits) from the introduction of Banksparen, the recent 'Woekerpolis affaire' (and the resulting Wabeke norm) and increased product transparency on margins. While life insurers will continue to play a key role in providing for retirement, these forces, in combination with the maturity of the Dutch market, will put considerable pressure on the insurance sector as it currently exists in the Netherlands. In this difficult environment, the major challenges confronting Dutch insurers are to develop new group life and decumulation products, to improve risk management and to reduce costs. The cost base of Dutch insurers is relatively high compared to the European average and has been increasing. This can be attributed to a high portion of distribution through intermediaries as well as the relative complexity of pillar 2 and 3 products in the mature Dutch market.

Non-life insurance is composed of three separate activities, health, personal and commercial, each with their own dynamics. Health insurance has been loss making after the regulatory reforms of 2006, although some players in this segment have returned to profitability. Consolidation is underway and increasing due to scale advantages in health and commercial – less so in personal. Generally speaking, non-life insurance products seem less affected by the economic crisis than life insurance products due to shorter term contracts and less investment exposure. However, lower asset prices in an L-shaped scenario and rising inflation in a U-shaped scenario could temporarily undermine profitability in personal lines.

The *pension market* in the Netherlands is one of the largest in Europe with an approximated EUR 700 billion in assets (at the outset of the crisis). While severely hit by the crisis, reflected in declining coverage ratios (some below 100%), it seems thus far to have weathered the crisis better than peers in many other countries. The financial situation of the Dutch pension funds depends primarily on investment strategy in relation to economic scenarios, especially on interest rate developments affecting the valuation of liabilities. Significant unrealized economies of scale exist in the Dutch pension market, since administration and investment costs are considerably lower for large funds than for small funds. A joint vision of the social partners would be needed to accomplish consolidation, because of differences in terms and conditions (e.g. indexation, wage basis and build-up, transfer of rights as function of coverage level) between pension plans.

The Dutch *asset management* market is primarily an institutional market accounting for over 90% of all assets. There is a global trend in asset management toward bipolar consolidation, with a few very large beta ('index') and combined alpha ('outperformance') players at one end, and smaller, specialized alpha boutiques on the other end. This trend is driven by significant economies of scale needed to maintain an index fund or a portfolio of alpha funds at low costs. While smaller than the largest global asset managers (some of which are managing close to a trillion in assets), several Dutch asset managers currently have sufficient critical mass (indicative set at EUR 75-100 billion in assets under management) to benefit from these economies of scale. If consolidation continues though, Dutch asset managers risk being 'stuck in the middle' in an increasingly specialized and competitive environment. For long-term sustainability, they may need to consider choices about scale and focus. A potential strength could be fiduciary management given the Dutch experience in this area and the well-developed pension fund sector. Like investment banking, this sector of the financial services industry thrives on individual talent, making talent retention in the Dutch environment a key challenge for development of this sector in the future.

An important question often raised is how the crisis will affect the attractiveness and validity of the pre-crisis business models and combinations of financial activities. In this context, this executive summary considers bank-insurance combinations and combinations of banking activities (see the full text in chapter 2 for other combinations of business lines).

The last two decades have seen an international trend of consolidation between *banks and insurers*. This was originally supported by business cases deriving synergies from cross-selling of insurance products through the bank channel, cost savings primarily in asset management and overhead and risk diversification resulting in lower capital requirements. With hindsight, analysis suggests that cost synergies were only partially realized, as banks and insurers continued to operate for the most part as separate companies, corporate cultures proved different, and the crisis demonstrated that risk diversification does not hold in times of distress. In addition, combining a large banking and insurance company may lead to additional complexities to manage. At the same time, the original value hypothesis of maximizing bank distribution channels for delivery of insurance products as a powerful combination remains valid. However, maintaining manufacturing and distribution within one institution is not necessary to realize economics, although ownership could facilitate integration. In addition, many Dutch bank-insurance combinations have had only limited success realizing the shift to the banking distribution channel. For the future, a variety of strategies remain possible, ranging from distribution contracts, to joint venture partnerships with insurers, to owning insurers for certain products with limited complexity and managed contagion risk.

With respect to *combinations of banking activities* we see clear synergies on dimensions such as shared use of infrastructure, shared balance sheet use, and customer overlap. These synergies may prove to be best achieved within one corporate entity to avoid high interaction costs. Retail and mid-cap banking effectively share branches and elements of the back-office infrastructure, while in addition retail savings provide an important source of funding for corporate lending. Mid-corporate banking can benefit from sharing products and (risk management) skills with large corporate banking. Finally, large corporate banking benefits from cross-selling capital markets and investment banking products to the same customer group. This illustrates how starting with a retail bank one could justify building it step by step into a 'universal bank'. The only activity for which a clear business case can be questioned is the extent to which such a universal bank should engage in proprietary trading. Whereas there could be an overlap in skills in areas such as capital markets and investment banking activities, expected increases in capital requirements in line with the risk profile for this activity will likely reduce the attractiveness of proprietary trading for universal banks.

In addition to the trends impacting the Dutch financial institutions and the impact potential scenarios may have, there are three additional requirements that could be important for the recovery and progression of the Dutch financial sector in the coming years. These are access to capital, effective risk management, and sufficient access to growth opportunities.

Firstly, access to capital will be an important condition for recovery of the financial sector. Investors are still waking up to the new reality of banking, with lower expected profit levels for the coming years and increased capital requirements affecting returns. Although the higher capital requirement will change the risk profile and required returns, earnings growth and a return to profit levels exceeding cost of capital will be needed to ensure sufficient investor interest. Apart from these financial and economic considerations, it will also be important to consider the shareholder position. Instruments limiting shareholders' rights might help to ward off the sometimes negative effect of shareholder influence on financial institutions, thereby possibly contributing to financial stability. They would also, however, likely result in a higher cost of capital for financial institutions, potentially limiting its longer term growth perspective.

Secondly, the crisis has shown that, for Dutch financial institutions, it is important to manage the risks that stem from domestic activities and exposure in foreign markets – the latter through the importation of systemic risks to the Dutch financial sector. In the regulatory environment, we see three levers to manage systemic risk of the financial sector. 1) Strengthen resilience of individual institutions by improving the role of the Board of Directors, the risk function, capital buffers and micro-prudential regulation. 2) Limit contamination risk and impact between institutions by strengthening macro-prudential monitoring and its connection with micro-prudential activities, including the assessment of systemic risks connected to foreign exposures. 3) Implement systemic measures, such as European burden sharing and an effective 'crisis toolkit'.

Thirdly, the financial sector remains a substantial contributor to Dutch GDP (~6.5% in 2007) and the Dutch economy. History shows that even severe economic downturns are followed by economic upswings. A well-functioning financial sector is instrumental in facilitating such an upswing. Therefore, while the current imperative is to focus on the effects of the crisis, it is important that both authorities and the sector keep a long-term perspective when evaluating policy actions.

1 Economic and Regulatory Scenarios

Over a five-year horizon, uncertainties are considerable, especially in light of the current instability. To get a better understanding of these uncertainties, we conducted a scenario analysis, opting for scenarios that we believe are feasible instead of purely theoretical stress tests. While we took the Netherlands as a starting point, the two scenarios that we constructed also reflect international developments, as these greatly affect circumstances in our country. In this chapter, we set out the scenarios as follows:

1.1 Dimensions of the scenarios:
As dimensions for our scenarios, we selected two uncertainties with a strong impact on the future – the business cycle and regulatory developments.

1.2 Description of the scenarios:
- A more optimistic scenario: U-shaped recession and intensified international cooperation
- A more pessimistic scenario: L-shaped stagnation and less international cooperation

1.1 Dimensions of the scenarios

Business cycle
The situation in the financial sector over the next five to ten years will to a large extent depend on business cycle developments. At this moment (June 2009), the outlook for the rest of the year appears bleak, with a substantial decline in GDP.[2] For the purpose of this exercise, DNB has developed two scenarios. In these scenarios, the drop in GDP is expected to be accompanied by a worldwide decline in asset prices, lower interest rates and inflation, a dramatic reduction in world trade, and rising unemployment. The scenarios take the situation in 2009 as given, but differ in the speed of recovery anticipated after 2009.[3] In the optimistic scenario, world trade and share prices partly recover from the situation in 2009 and GDP growth becomes slightly positive from 2010 onwards. In the pessimistic scenario, world trade, share prices and the Dutch housing market decrease further in 2010, leading to a prolonged recession, with GDP growth not recovering until 2013.

Regulatory developments
Regulations are part of a larger government and supervisory intervention that aim to remedy the current crisis and ensure long-term market stability and minimal systemic risk. In April 2008, the Financial Stability Board (FSB) published a set of policy recommendations to improve the working of the financial system. These recommendations relate to five areas: (1) prudential oversight; (2) transparency/valuation; (3) credit rating agencies; (4) strengthening authorities' responsiveness to risks, and (5) crisis management. The amplification of the financial crisis after the bankruptcy of Lehman stimulated the implementation and elaboration of these proposals, e.g., by the Basel Committee and the G20. At this moment, a strengthening of European regulation in some or all of the following areas is expected in both the optimistic and pessimistic scenarios:

1. Higher and counter-cyclical capital requirements, particularly for complex structured (re-securitized) products, counterparty risk in the trading book, and liquidity facilities to off-balance sheet vehicles;

2. Increased supervisory oversight of risk management capabilities and practices, including more emphasis on stress tests and inclusion of historical stress data in VaR calculations;
3. Higher standards for transparency on risk disclosure for banks and near-banking entities;
4. Increased regulation of near-banking institutions e.g., SIVs, mortgage brokers and hedge funds;
5. Increased requirements for securitization, e.g., keeping part of the risks on the balance sheet, providing more transparency, and improving the quality of underlying assets;
6. Modified compensation structure across many levels of organization, e.g., stronger long-term incentives, lower reliance on bonuses;
7. More standardization and centralization of derivatives products;
8. Revised code of conduct for Credit Rating Agencies.

Besides the above-mentioned areas of regulation, one could conceive of other measures that are more dependent on the extent of collaboration between regulatory authorities in different jurisdictions – e.g., national liquidity rules. These changes in the regulatory framework and global financial architecture partly depend on the extent of international collaboration. In Europe, it has recently been decided to establish a European System of Financial Supervisors (ESFS), consisting of three sectoral European Supervisory Authorities (ESAs), and a European Systemic Risk Board (ESRB) in 2010. These institutions are expected to contribute significantly to the integration of financial supervision in Europe; in this respect it is important that the ESFS will get binding decision-making powers in some specific areas. However, it is not clear yet to what extent the integration of financial supervision will materialize in practice, since it has also been agreed that decisions taken by the ESFS should not impinge in any way on the fiscal responsibility of Member States.

1.2 Description of the scenarios

One can define two potential states of the world by combining the macroeconomic scenarios with the regulatory outlook. In one scenario, the economy recovers relatively quickly, regulators focus on market effectiveness, and international collaboration is successful and stimulates economic growth. This is the so-called 'U-shaped' scenario. The other scenario is a downward spiral in which the economy does not recover rapidly and regulators primarily focus on risks and policy measures from a national point of view, which hinders economic recovery. This is termed the 'L-shaped' scenario.

Since the economic cycle and international cooperation tend to reinforce each other, we did not analyze in detail the consequences of a deep recession in combination with successful international cooperation and a relatively mild recession in combination with a more nationalistic supervisory approach.

U-shaped recession and intensified international cooperation
This is a possible scenario in the case of a relatively quick recovery of the economy. The scenario was generated for the purpose of this exercise based on projections made with MORKMON, the macroeconomic model developed by DNB.

This scenario is characterized by conformity of ideas and goals, absence of national hubris, and the belief that global concerns outweigh domestic interest. Effective global cooperation, driven by the G20, prevents protectionism in both the financial and non-financial sector, and the current trend of international cooperation for international regulation continues. In this scenario, the underlying belief is that the risks faced by financial institutions are inherently global, given the interconnectedness of global markets. Within the EU, individual governments in this scenario prove to be committed to strengthening financial integration by means of common supervisory arrangements, which are seen as a necessary complement to the single market and the euro.

In this scenario, the ESFS would prove to be influential with regard to the micro-prudential supervision of financial institutions. Colleges would function adequately, especially for large, internationally active financial institutions. Some international agreement would be reached on crisis management and burden sharing for capital injections. However, a European deposit insurance system might not be created as yet due to political barriers and the sheer magnitude of the funds involved. The macro-prudential analyses of the ESRB would also have the desired impact on micro-prudential supervision by national authorities.

There would be no changes to the branch model ('passport right'). Although overall liquidity rules would become stricter and rules based instead of principle based, harmony would increase between European countries and there would be a greater possibility of pooling liquidity over countries.

There would be almost no intervention in the structure and activities of individual financial institutions. Instead, governments would seek to reduce systemic risk by delegating more power to international supervisory institutions at European level arguing that the financial system is too interconnected to isolate individual institutions from international financial turmoil.

L-shaped stagnation and less international cooperation
On the other end of the macro-economic and regulatory dimensions is the L-shaped scenario. The developments anticipated for 2009 are exactly the same as in the U-shaped scenario, but the L-shaped scenario would see continued negative economic growth in 2010, instead of a recovery that characterizes the U-shaped scenario.

Very few would argue for decreased international cooperation, as this increases risks and represents considerable downsides for economic growth. However, in this scenario, the fact that several national governments were forced to absorb the cost of financial failures outside their borders might led them to conclude that there is an inherent paradox between the passport regime and being a provider of deposit insurance and lender of last resort.

In the L-shaped scenario, the process of internationalization of regulation would halt. Subsidiaries become a dominant mode, enforced either by moral persuasion or changing European regulation. The ESFS would prove to be less influential than currently envisaged. National authorities and central banks would remain the most important parties in both micro- and macro-prudential supervision, as they carry ultimate supervisory responsibility in their countries. Capital injections and deposit insurances would remain exclusive national affairs. Liquidity requirements would be set by each country. This would drive up total liquidity needs, as financial institutions that operate internationally would be unable to pool their liquidity across borders. Governments, in their attempt to minimize risk, might intervene in the structure and activities of the local financial institutions. For example, they might enforce stricter product regulation in order to standardize products (e.g., standard mortgages) and thus, increase transparency for customers.

2 Analysis of (Combinations of) Business Lines

This chapter presents trends and other key developments per business line (2.1–2.7). For business lines that are mainly national – retail banking, mid- and large corporate banking, life insurance, non-life insurance – we first describe trends in Europe, as a benchmark for analyzing national developments (with the exception of pensions, where the analysis is mainly national given the specific, national characteristics of this business line). For business lines with a strong international character – investment banking and asset management – we first describe trends on a global level, as a benchmark for analyzing the Dutch market. We also sketch the expected level of national and international consolidation for the various business lines, which often depends on the scenarios. This chapter concludes with an assessment of various combinations of business lines (2.8).

2.1 Retail banking

Trends (Europe)

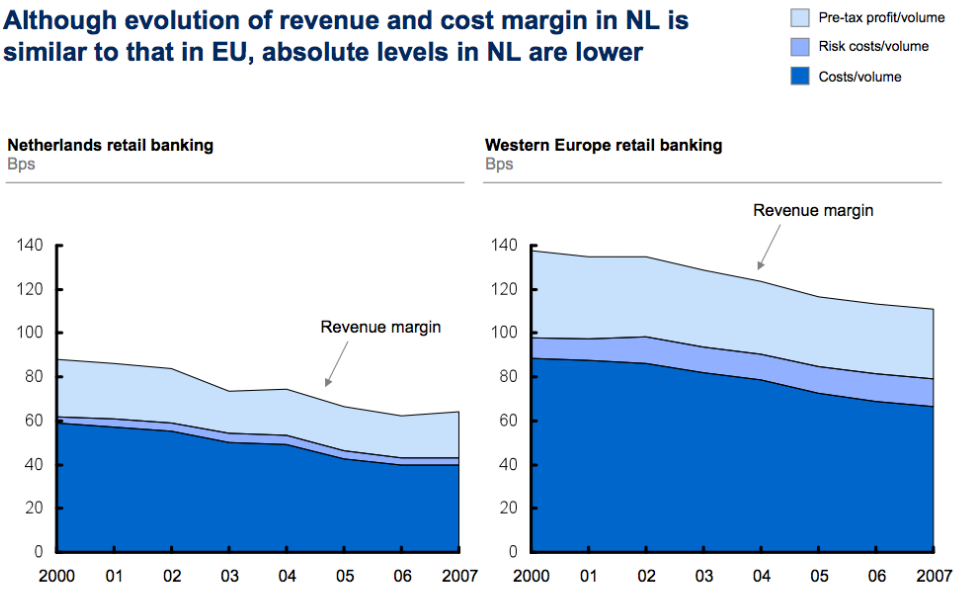
For retail banks, it is crucial that customers trust that their savings and investments are safe. According to marketing experts, 22% of the population in the United States, the UK, Germany and France do not trust their banks anymore.[4] An important consequence of structurally lower trust levels is that consumer loyalty, which already showed a declining trend, may decrease further.[5] Particularly individuals in the affluent and high net-worth segments spread their savings over several banks and are increasingly willing to transfer their savings at short notice. This may negatively impact on the profitability of individual retail banks, which typically earn more than 50% of their profits in this segment. In this respect, it should be noted that current competition in retail banking disturbed by deposit guarantee schemes (DGS), with a harmonized limit of EUR 100,000 in Europe, which safeguards the savings of the lion's share of customers. This is particularly true in countries where the DGS is not funded by means of risk-dependent premiums.

The profitability of retail banks will likely remain under pressure in the coming years and, in many cases, losses may not be avoided. The first reason for this is that the financial crisis and ensuing recession have reduced the demand for retail products – e.g., mortgages (in the Netherlands, particularly for so-called *tophypotheken*), consumer credits, and loans to small and medium-sized enterprises (SMEs) – because of the deleveraging by SMEs and consumers. The effect of reduced demand is reinforced by a more cautious approach to lending by retail banks: for example, Dutch retail banks increased net interest margins on new mortgages at the end of 2008.[6] In addition, the recession that has materialized so far will have a lagged effect on non-performing loans in the coming years, since consumers and SMEs usually first use their buffers before they default on their loans. A last reason for pressure on profitability is the increase of capital requirements by financial markets and (when the financial crisis has abated) regulators.

Generally, retail banks have three levers for increasing their profitability: The first is to increase revenues through improved customer experience (effective client management, targeted product offering, service levels and channel management) in addition to pricing practices (fair charges for payments, layered pricing for deposits, management of leakage etc.).

Figure 1

Although evolution of revenue and cost margin in NL is similar to that in EU, absolute levels in NL are lower



SOURCE: McKinsey Global Banking Pools; DNB; Datastream

The second lever is cost management, which has traditionally been an important driver for the profitability of retail banks, given their high fixed costs and the relatively low margins per customer. There are three main drivers for managing operational costs (in order of impact):

1) Applying so-called lean methods (first-time-right, no waste), which eliminate activities from processes that do not add value;
2) Simplifying the product portfolio and IT systems and reducing overhead (particularly relevant for large banks);
3) Migrating clients to direct channels like remote banking.

A third lever is improving risk management and collection management to control non-performing loans.

Snapshot of the Dutch market

With revenues estimated at approximately EUR 13 billion in 2007, retail banking accounts for nearly half of the total banking revenues in the Netherlands. Despite concentrated character of the market[7], there are reasons to believe that competition in the Dutch retail market is high, as a result of relatively simple and transparent products, the increased use of the internet channel (in the Netherlands, 68% of the population used online banking at least every three months in 2007), and the presence of new entrants. The relatively low costs and revenues of Dutch retail banks vis-à-vis the European average, as illustrated in Figure 1, may indicate the competitiveness of the market, but other factors might play a role here as well. For example, the high density of the population is a cost-reducing factor, as it increases the efficiency of branches. A revenue-reducing factor is the low fees on payment products in the Netherlands. Although payment systems in most European countries are loss making, this is usually compensated for by revenues on current accounts. This is not the case in the Netherlands, with a pre-tax profit per capita of EUR-39 for payments in 2005 (including current accounts) compared to an estimated average of EUR 33 in the EU15.[8]

In spite of the financial crisis, trust levels in Dutch banks are still relatively high compared to other European countries. This may be explained by the fact that trust levels have traditionally been high and that a large part of the Dutch banking sector was nationalized at an early stage in the crisis.[9] One consequence of low trust and the resulting increase in competition is a reduced scope for cross-selling to cover the costs of the loss-making payment system.[10] Secondly, the low trust in banks in general undermines the position of small retail banks for clients with deposits over EUR 100.000. People with large deposits, some of whom might have stalled the full amount with small banks before the crisis, may choose to spread these deposits over several banks or opt for a nationalized or large bank.

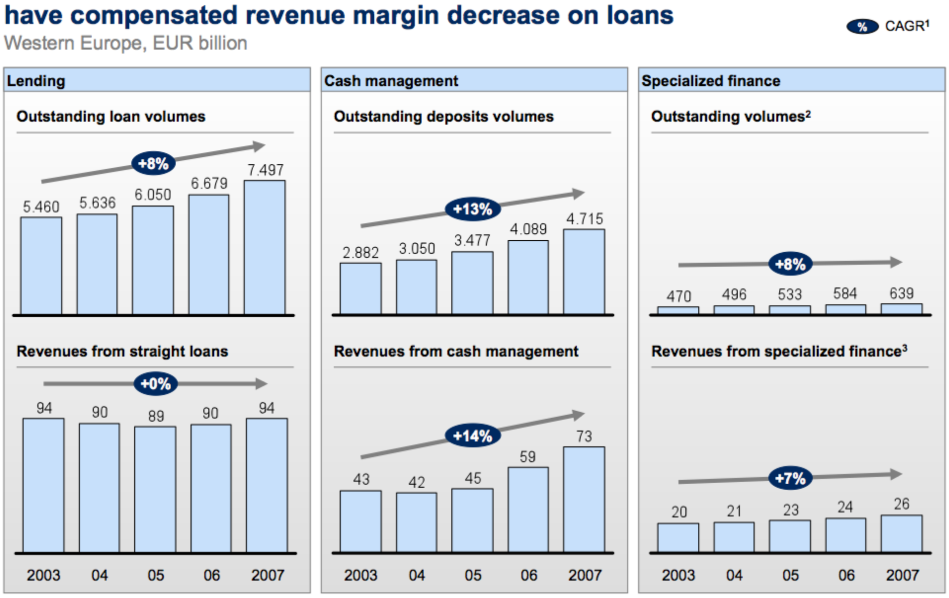
Like their European counterparts, Dutch retail banks will likely need to improve profitability to counter the effects of lower volumes, non-performing loans and higher capital requirements. Particularly in an L-shaped scenario, non-performing (mortgage) loans are likely to increase. While the mortgage default risk is lower than in other European countries (because of the NHG, among other factors), the loss on a loan default is higher, as loan-to-value ratios are higher than in other European countries.

Dutch retail banks have opportunities for increasing revenues by improving customer satisfaction. According to Independer.nl, customer satisfaction of Dutch retail banks is low, which is not unlike other European countries.[11] It could be possible for Dutch banks to improve customer experience and lower costs simultaneously by introducing end-to-end lean processes, less complex organizations, and low overheads. With respect to cost management, it should be noted that online and remote banking has already increased sharply in the Netherlands in recent years, resulting in a closure of 31% of branches between 2001 and 2007. Since this closure probably did not fully translate into efficiency gains (FTEs at credit institutions declined 8%) and branches are an important way to

Figure 2

Value added products, such as cash management and specialized finance, have compensated revenue margin decrease on loans

Western Europe, EUR billion



1 Compound annual growth rate
2 Outstanding volumes refer to leasing and factoring
3 Revenues refer to leasing, factoring, and trade finance
SOURCE: McKinsey CIB Profit Pools

build trust among consumers and strengthen the stickiness of deposits, we might expect a shift to more efficient branches instead of a substantial further closure of branches.

2.2 Mid- and large corporate banking

Trends (Europe)

As in retail banking, the profitability of European corporate banks is under pressure as a result of the financial crisis and ensuing recession.[12] Firstly, significant write-downs are expected. In this environment, early warning signals and corporate workout processes and capacity are a crucial part of adequate risk management, and thus a key success factor. A bank that actively supports and advises its clients (e.g. with respect to liabilities restructuring) can minimize its losses. Secondly, market participants regularly point to a decline in lending volumes. This decline can be ascribed to a combination of reduced lending appetite of banks and the reduced demand for credit as a result of the economic downturn and ongoing deleveraging by corporates. Incidentally, ECB figures for the euro area point to a marked deceleration of credit growth to non-financial firms since the autumn of 2008, measured on a yearly basis. Measured on a monthly basis, long-term credit growth to non-financial firms (longer than 5 years) was still positive in March 2009, but the growth of shorter maturities had turned negative. The ECB lending survey from April shows that credit tightening has been less severe for high-quality borrowers than for low-quality borrowers.

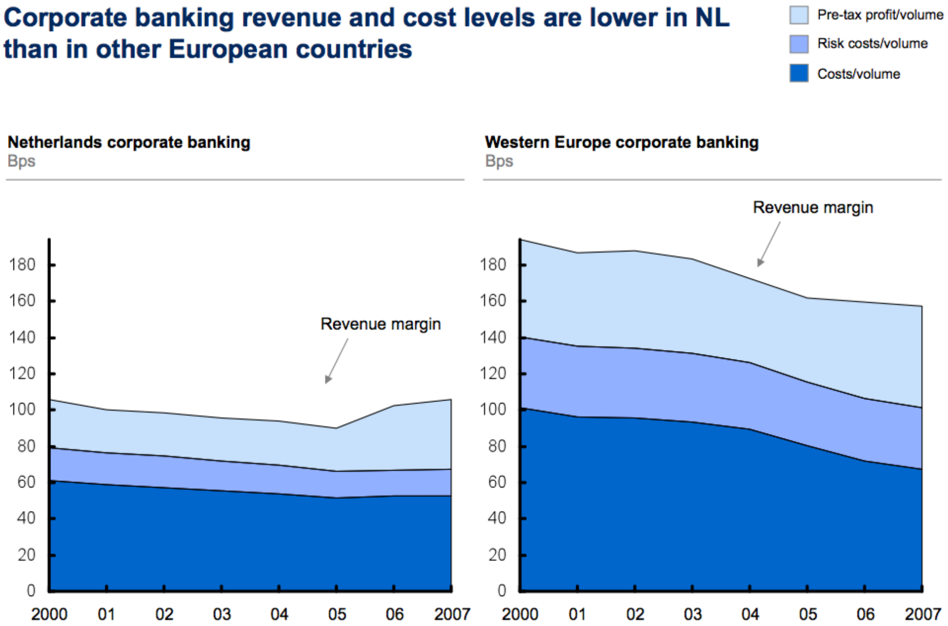
Generally, competitive forces are stronger in large corporate banking than in mid-corporate banking. In the mid-corporate segment, long-term relationships are important (firms often prefer to deal with their personal account manager), switching costs are high for certain products (due to the high administrative burden), and entry barriers exist due to the necessity of a local branch network. Mid-corporates are more dependent on their banking relationship than large corporates, and this dependency might intensify in economically tough times. In the low interest rate environment preceding the financial crisis, competition increased in both segments against the background of a worldwide search for yield. Margins on pure corporate lending in Western Europe shrank significantly (about a third of margins were squeezed in the period 2003–2007, as illustrated in Figure 2). Since the start of the financial crisis, tighter capital and funding constraints have forced banks to focus on core markets and core customers. This move is accompanied by an increase in margins on short-term loans to multinationals, large corporates and mid-corporates by European banks, according to initial figures.

An important characteristic of mid- and large corporate banking is that straight loans (with very thin margins) are used as a 'hook product' to sell more profitable products like cash management, specialized finance and capital markets products (which are part of the business line Capital markets and investment banking, discussed below). Cross-selling multiple products to the same client, rather than just providing credit is crucial for profitability. The financial crisis has probably not changed the principle of cross-selling in corporate banking, but it has affected its implementation in practice. As a result of capital constraints, large clients in particular have less choice among banks, which gives the remaining banks the opportunity to claim a larger share of the profitable cross-sell products (a larger 'share of wallet'). This counterbalances the 'back to basics' trend in corporate banking – a reaction to the financial crisis, which has reduced the possibilities to cross-sell complex specialized finance and capital markets products.

We might expect more international consolidation in mid- and large corporate banking, as well as in retail banking in the U-shaped rather than the L-shaped scenario. With regard to consolidation on a global level, banks in developed countries are expected to have more financial strength to expand in emerging economies in the U-shaped scenario. In Western Europe, there has been some cross-border consolidation so far. The

Figure 3

Corporate banking revenue and cost levels are lower in NL than in other European countries



SOURCE: McKinsey Global Banking Pools; DNB; Datastream introduction of SEPA might stimulate the pace of consolidation, as it becomes easier to offer payment services across the Eurozone.[13] However, the regulatory response to the financial crisis might have more influence on the pace of banking consolidation in Western Europe. Since we have assumed that the L-shaped scenario coincides with a more nationalistic approach to supervision, cross-border synergies would be lower due to the prevalence of subsidiaries, which benefit less from capital and liquidity pooling. Moreover, the bad economic environment with large credit losses might force banks to focus on their home markets and spin-off non-core activities. These trends may be less likely to materialize in the U-shaped scenario, which assumes intensified international regulatory cooperation.

Snapshot of the Dutch market

The Dutch mid- and large corporate banking market is slightly smaller than the retail banking market, with 2007 revenues estimated slightly above EUR 9.5 billion. Figure 3 shows that overall revenue and costs levels of Dutch corporate banks are below Western European levels, but have not declined as much. The low Dutch revenue margins are partly the result of a relatively low share of mid-corporates (32% of revenues versus a Western European average of 53%) and relatively high levels of collateralized loans (with lower margins). Lower costs are the result of a more limited branch network, and lower risk costs can be ascribed to a historically low risk profile of Dutch corporates.

Despite recent changes in ownership of the Dutch banking sector, Dutch mid- and large corporates are still believed to have sufficient access to corporate and investment banking products to serve their domestic needs. Large corporates appear to be increasingly served by foreign banks, both for domestic and foreign needs. Dutch corporate banks will need to maintain an (internationally) competitive product palette to ensure profitability over time.

In line with the situation in other European countries, competition in the large corporate segment is higher than in the mid-corporate segment, as large corporates often work with more than 10 banks (local banks and international banks) and have more buying power. Mid-corporate clients with foreign activities might have fewer options because of the limited availability of Dutch banks with a foreign international network; the required divestment of a portion of ABN AMRO's Dutch banking network by the European Commission could provide mid-corporates more choice of banks.

Recent interventions by governments and central banks have illustrated the need to improve risk management practices for the sector as a whole. However, there are no indications that Dutch banks have worse credit risk management capabilities than other European banks. Experiences from European and US-based banks suggest the Dutch corporate banking sector may also need to scale up non-performing loan warning systems and work out capabilities and capacity in light of the current crisis. A large amount of funding will mature and require refinancing in the coming years. Players who are highly dependent on wholesale funding or securitization need to reevaluate their funding model, depending on the opportunities on capital markets.

The impact of the future scenarios on mid- and large corporate banking is mainly determined by exposure to credit losses. In the L-shaped scenario, this sector would suffer substantially larger losses on corporate loans than in the U-shaped scenario.

2.3 Capital markets and investment banking

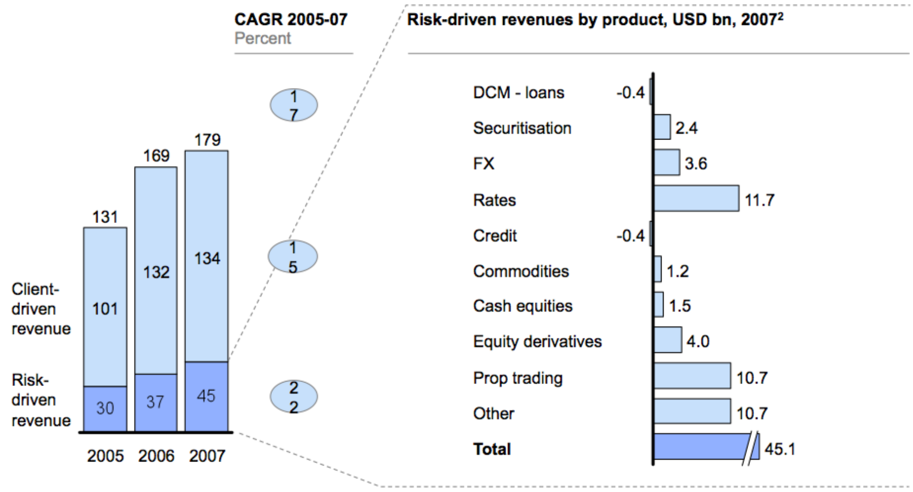
Trends (global)

The business line capital markets and investment banking (CMIB) is by nature very sensitive to the business cycle.[14] It is therefore not surprising that investment banks were

Figure 4

Risk-driven revenues have grown faster than client-driven revenues

EMEA[1] capital markets & investment banking revenues,
USD billion, 2005-07, constant 2007 exchange rates, pre-writedowns

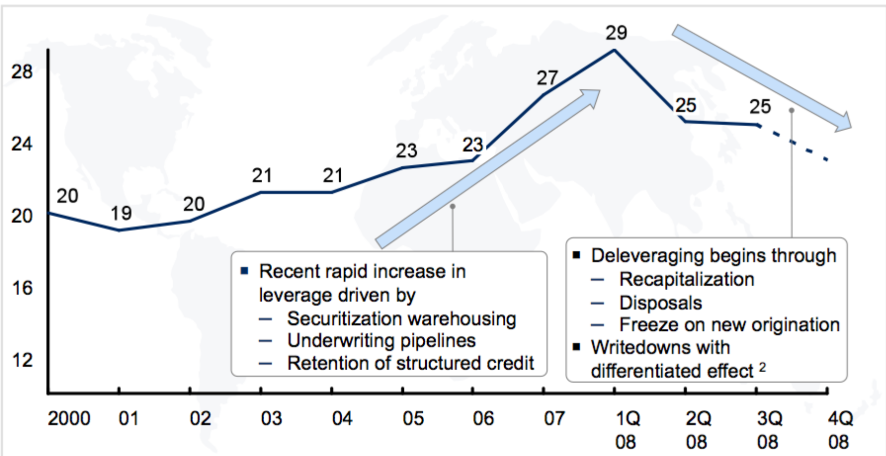


1 Europe, the Middle East and Africa
2 Before writedowns
SOURCE: McKinsey Global Capital Markets Revenue Pool 2008

Figure 5

Global banks' leverage ratios increased rapidly during the boom, with the deleveraging process beginning this year and likely to continue

Leverage ratios of leading investment banks on balance sheet, assets to equity[1]



1 Assets are 'Total Assets' as taken from Financial Statements. Equity is taken to be Shareholder's Equity. Includes UBS JP Morgan, Citigroup, Deutsche Bank, Lehman Brothers, Morgan Stanley, Goldman Sachs, Merrill Lynch, Credit Suisse. At the end of 2007, there were ~$200b of assets in SIVs off balance sheet. This represents 2% of the $12tr of assets held on balance sheet, and therefore does not materially impact the on-balance sheet leverage ratios
2 Writedowns creating overall losses have increased leverage through capital reduction, writedowns 'only' reducing profits have reduced leverage
SOURCE: Company reports; press search; team analysis

among the first victims of the financial crisis, after global revenues earned with CMIB had shown unprecedented growth in preceding years (Figure 4 shows notably growth in earnings on relatively risky CMIB activities in the period 2005–2007). Investment banks were hit by four major blows: write-downs, overleveraging (due to an accumulation of assets intended for securitization stalled in the pipeline and write-downs, see Figure 5), reduced deal volumes, and loss of liquidity (due to the traditionally high dependence on wholesale funding).

Future profitability in CMIB is highly dependent on the scenarios: In the L-shaped scenario, there might be a prolonged period of limited M&A activity and a relative shift to lower-margin products, including secondary market flow products such as FX, rates and commodities. Furthermore, there might be fewer IPOs, corporate bond placements, transactions for hedge funds, and proprietary trading for universal banks. If capital requirements were to increase, profitability would further decrease. In the U-shaped scenario, profitability would be expected to pick up again, especially due to an increase in local activities.

Key success factors in CMIB are scale and, related to that, placement power and people. A first important aspect of scale is a strong balance sheet with sufficient solvency and liquidity, which enables banks to underwrite large deals. Scale advantages exist in capital markets, as larger players can afford to invest in state-of-the-art IT, which is a major driver in cost per trade. Placement power depends on a strong and large network in capital markets. Success in this business line also depends on talented people (skills in sales, trading, product structuring, mid-office and pricing). Because of the importance of scale, there has historically been a strong trend of consolidation with large players gaining market share. As a consequence, the biggest 15 global banks earn around 50% of CMIB-revenues. The existing consolidation trend will probably be strengthened by the effect of the financial crisis.

Snapshot of the Dutch market

2007 was an extraordinary year with estimated revenues of nearly EUR 5 billion in the Netherlands, primarily due to significant M&A activity.[15] In the Dutch CMIB-markets, various types of player are active: global players, regional players, national players and boutiques. The global players hold ~50% of the share in revenues, serving the Netherlands often from another financial hub. Dutch players have been losing market share to the global players over time, especially in the segment of large corporates and institutions. The crisis and the need for lending could reverse this trend temporarily by demanding cross-sell of capital market products with loans.

With respect to the key success factor scale, both balance sheet size and trading volumes of Dutch banks are lower than those of regional and global banks. Major pure play investment banks have EUR 700–1,000 billion in assets, at least five times more than the amount Dutch banks have allocated to CMIB activities. Dutch players offer more exotic and complex capital market products 'white labeled'. They also have a more limited and national network for covering investors than global and regional players, which reduces their placement power. Historically, attracting talented people has been difficult for Dutch banks, due to the proximity of London.

2.4 Life insurance

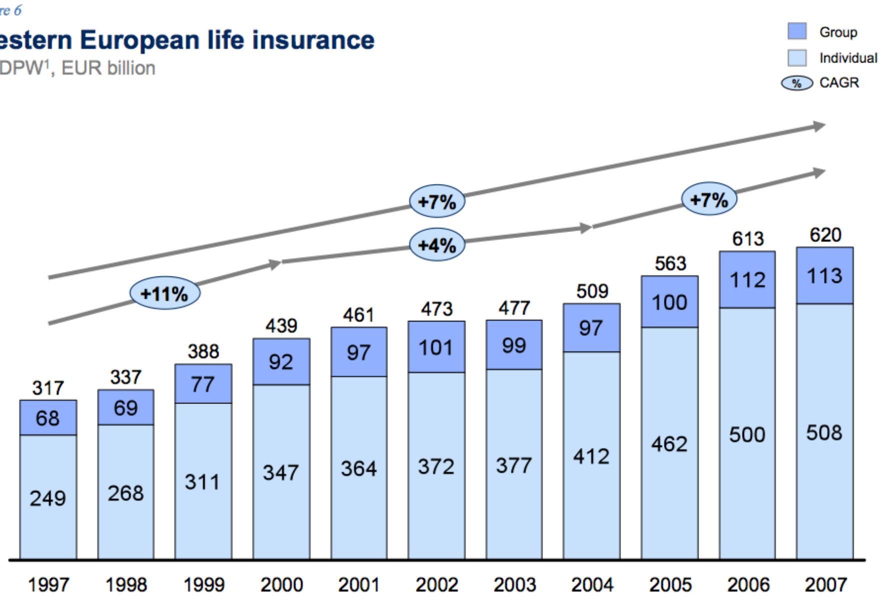
Trends (Europe)

Figure 6 shows a compound average annual growth in Gross Direct Domestic Premiums Written of 7% in the period 1997–2007, driven by booming financial markets and an ageing population. However, the financial crisis and ensuing recession has hit European life insurers hard. Firstly, the fixed-income holdings of life insurers were severely affected

Figure 6

Western European life insurance

GDDPW[1], EUR billion



1 Gross Direct Domestic Premiums Written; Includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom

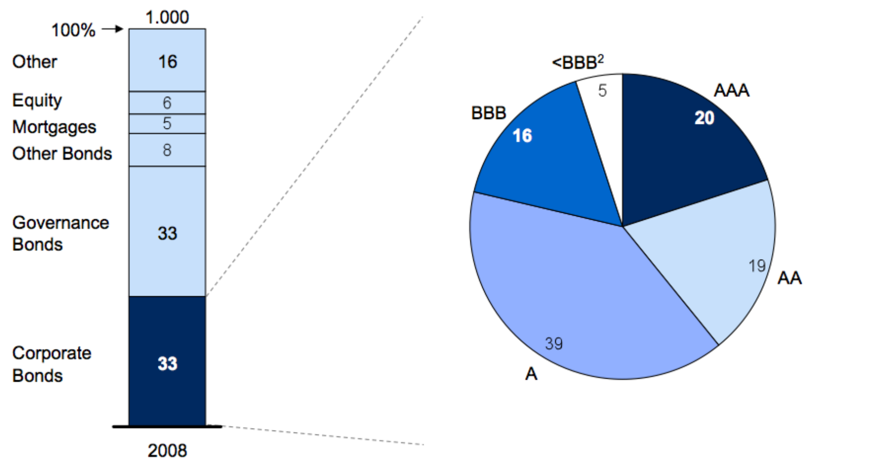
SOURCE: Local statistics; McKinsey life insurance size and growth database

Figure 7

European insurers have large exposure to corporate bonds, widening credit spreads and enhanced default risk could lead to further (unrealized) losses

Asset mix general account investments[1]
2008, EUR billion, percentage

Corporate bonds by rating[1]
2008, percentage



1 Based on sample of 5 large European insurers
2 <BBB or not rated

SOURCE: Annual reports; analyst presentations by the exposures on corporate bonds, which have declined in value because of increased credit spreads. For instance, a group of five large European insurers hold 33% of their investments in corporate bonds, of which 21% are rated BBB and lower (Figure 7). Secondly, low interest rates have a detrimental effect on profitability because of a reduced interest rate spread between the market rate and guaranteed rates on existing traditional insurance policies. In addition, European insurers recorded losses on their equity portfolios, although these were relatively minor as many insurers had reduced the share of equity in the investment portfolio in the aftermath of stock declines in 2002 and 2003.

In spite of these adverse developments, there is a future for life insurance. Firstly, life insurers are well equipped to deal with longevity risk. Secondly, given the diminished expectations of state-financed pillar 1 schemes, life insurers are expected to have an important and growing role to play in retirement provision in Europe. However, in some mature markets, this business case might justify a smaller life insurance sector than we currently have. In this respect, it should be noted that many (life) insurers depend heavily on profits earned on an apparently risky investment portfolio (corporate bonds, interest rate and equities), and a limitation of investments to less risky assets would structurally dampen the revenues of European life insurers. In addition, it is expected that new business volumes could be under pressure in the coming years, since declining equity markets have reduced consumers' appetite for unit linked products, an investment product sold by insurance companies. Incidentally, the growth of unit linked products was most buoyant within the individual life segment, with an average yearly growth rate of 15% in the period 1997–2007. Finally, it would be very hard to offer profitable guaranteed products if long-term interest rates were to remain low. It is expected that the negative effects of depressed equity markets and low interest rates on new business in life insurance will be larger in the L-shaped than in the U-shaped scenario.

Snapshot of the Dutch market

Group and individual life products respectively generated around EUR 8.8 and EUR 17.6 billion gross premiums written (GPW) in the Netherlands in 2007. The Dutch life market is moderately concentrated with the top six groups holding a share of 88% of GPW in 2007.[16] National consolidation has increased over the last years in response to scale advantages in IT systems, distribution and overhead, and is likely to increase further, given the tail of small players beyond the top 6 that have a share below 2% of GPW. The potential for cost synergies is reduced by the fact that products are complex and have long durations, which increases legacy problems in merging IT systems and back-office teams.

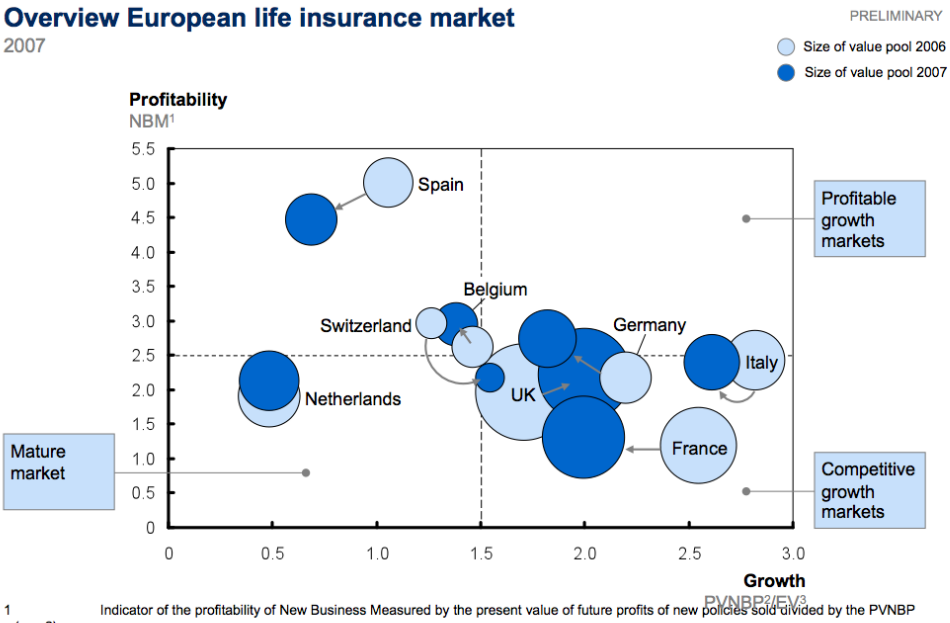
Competition in the Dutch market seems high, as indicated by low new business margins of 2.1% versus the European average of 2.5% (Figure 8).[17] New business margins have decreased in recent years due to the limited growth of the overall market, the role of actuarial advisors and consultants tendering especially group life contracts and obtaining multiple quotes, increased competition from banks and strong pressure on cost levels (Wabeke). Compared to other European countries, the Dutch life market was still relatively profitable on their in-force business in 2007 (return on reserves of 124 bp vs. European average of 48 bp), primarily due to a lower share of profit participation in the Netherlands.

The future profitability of the life insurance business is highly dependent on which scenario occurs. In the L-shaped scenario, we could enter a Japan-like situation with low long-term interest rates and depressed equity markets, in which it becomes very challenging to offer life products in an attractive way. Additionally, the combination of defaults on corporate bonds, low interest rates and low equity markets could lead to large losses on life insurers' existing in-force book. In the U-shaped scenario, the picture looks less bleak, since interest rates increase gradually. This has a positive influence on

Figure 8

Overview European life insurance market

2007



1 Indicator of the profitability of New Business Measured by the present value of future profits of new policies sold divided by the PVNBP (see 2).
2 Present Value of New Business Premiums
3 Embedded Value: the present value of future profits plus adjusted net asset value

SOURCE: McKinsey European life value pools new business margins while maturing bonds can be re-invested in bonds with attractive yields and defaults on corporate bonds will be limited.

In both scenarios, the business climate may prove less attractive for Dutch life insurers than for the rest of Europe, because of the introduction of Banksparen in January 2008 (law Depla De Vries), the 'Woekerpolis affaire' in 2008 and new regulation on commissions transparency. Banksparen is a severe challenge for products sold by life insurers: as of 2008 banks are allowed to offer banking products with the same fiscal advantages as life products, e.g. when people have a pension deficit, they can use this banking product to save free of wealth taxes.[18] In addition, trust was reduced after the 'Woekerpolis affaire', which exposed high cost loadings on customers' individual unit-linked life policies. Since then, insurers cannot charge more than 250 bp of reserves for unit-linked products (Wabeke norm) as yearly cost loadings. Rules under the Act on Financial Supervision are expected to oblige intermediaries to be transparent about their remuneration, which may lead to a further professionalization and shake-out of the broker channel. Finally, the ambitions of pension funds to grow in the insurance market could prove an extra risk factor for the sector. It needs to be assessed whether these ambitions will lead to fair competition. In this environment, the major challenge for Dutch insurers is to survive while they reduce costs (which includes adapting the distribution mix), improve risk management skills, and build trust by increasing transparency and customer focus.

The costs of the Dutch life insurance lie above the European average, with an average expense ratio of 13% between 2000 and 2007, vs. 10% in Europe. These higher costs are caused by:

1) the high costs associated with the typical broker market with commissions in relation to countries with mainly a banking distribution network;
2) the relative complexity of the more mature Dutch pillar 2 and pillar 3 life insurance products.

In addition, cost focus appears to have been lacking, with expense ratios increasing from 12.6% in 2000 to 13.5% in 2006, while they decreased with 4.9% in European countries with a banking distribution model and 6.7% in European countries with a broker/tied agent distribution model. As in other European countries, multichannel distribution is slowly but surely gaining ground in the Netherlands.

Dutch life players have received relatively large capital injections, which were the result of a relatively large share of life insurance vis-à-vis non-life insurance, a stretched capital base of some Dutch financial institutions due to recent acquisitions, and relatively high exposure to the US. As in the rest of the European life insurance sector, risk management of Dutch players needs to be strengthened.

In terms of marketing and distribution skills, a simplified product portfolio and targeted propositions for group life will be increasingly important. In addition, two distribution issues specific to the Netherlands need attention. First of all, the introduction of Banksparen forces insurers to rethink their bancassurance model, as banks are offering their own products. Secondly, the broker channel is under high pressure at the moment (due to bankruptcies, liquidity issues, increasing costs).

2.5 Non-life insurance

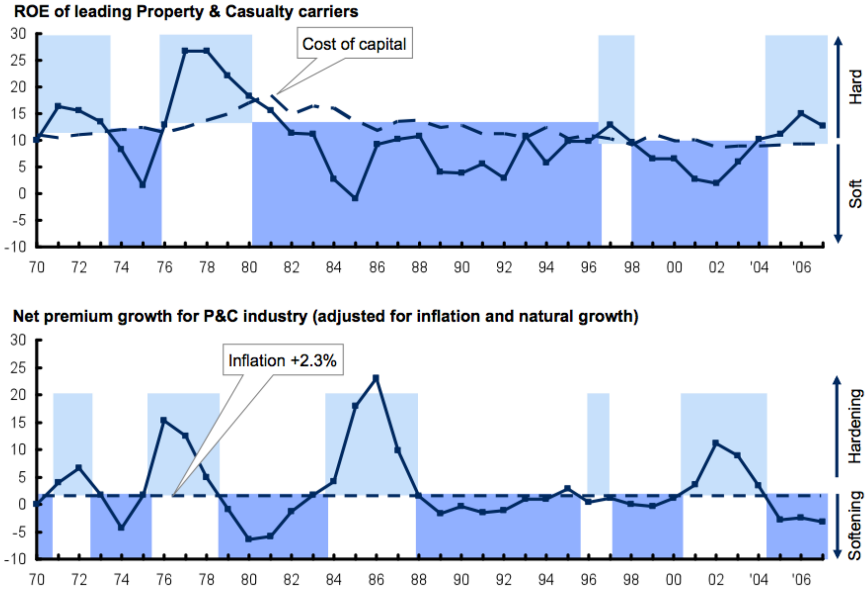
Trends (Europe)

The profitability of the non-life sector is driven by a specific cycle, which, in general, has the following pattern: an adverse external shock erodes the capital base of the insurers; insurers withdraw capacity from riskier lines and premiums are raised to restore capital; underwriting tightens and profitability improves; companies expand current book and

Figure 9

Description of the cycle

Percent, 1970-2007, US example

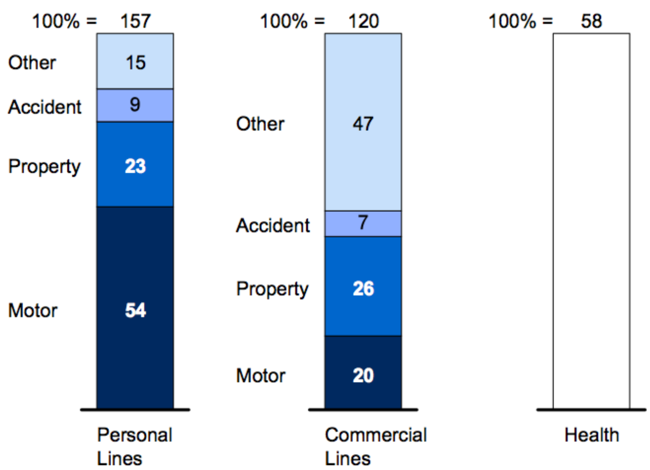


SOURCE: Conning & Company; Standard & Poor's; Insurance information institute; team analysis

Figure 10

European non-life market split by business line

GDDPW[1], 2006, EUR billion, Percent



1 Includes AUS, BEL, DEN, FRA, GER, ITA, NOR, POR, SPA, SWE, SWZ, and U.K. Note that Netherlands is excluded owing to lack of data

SOURCE: McKinsey non-life insurance size & growth database open new business; increased competition lowers prices and margins (Figure 9). This sector is less sensitive to economic circumstances than other business lines, as prices are less sticky. However, personal and commercial lines may well suffer from the crisis, mainly due to lower volumes and worse investment results. Health insurance is not expected to be severely impacted by the crisis, as health costs and demand for health insurance are expected to continue to increase and prices are adjusted on an annual basis.

The non-life insurance market consists of three completely different businesses: personal lines, commercial lines and health insurance (Figure 10).[19] Personal lines are primarily a local business. Multichannel distribution with an increasing role for direct writers and banks is slowly gaining ground. Players in this segment face the challenge of reducing costs, including commissions of brokers, to deal with increasing transparency and commoditization. Commercial lines are a global business, which requires a global business model and the specific in-depth skills for accepting risks. Health insurance is a very local market driven by legislation. The Dutch market is the most privatized market, but has been loss-making since the regulatory reform in 2006. Profitability might be improved by focusing on improvements in claims handling, medical procurement and operational excellence in the short run and marketing skills in the long run. The European health insurance market is expected to grow substantially due to the aging population and the increasing role of the private sector in the health market

Domestic consolidation will probably continue. One reason for this is that large foreign insurance companies are reconsidering their multi-country presence, resulting in divestments from smaller, non-strategic markets. In addition, there are scale advantages in domestic consolidation, as demonstrated by publicly announced, ex ante, in-country synergies of 40–50% of deal value[20] for personal and commercial (P&C) lines, in overheads, distribution and IT-platforms. Commercial lines probably have the largest scale advantages, followed by health (because of the more standardized product, such as the *basisverzekering* or basic insurance in the Netherlands). Scale advantages in personal lines are less pronounced. In the latter, especially technical results may be higher for larger, focused players due to portfolio effects and better underwriting skills, but this effect is partially offset by increasing complexity costs.

With regard to international consolidation, it should be noted that both life insurance and health insurance are by nature more nationally oriented markets than commercial and personal lines. In life insurance, differences in pension systems and fiscal regulation result in consumers having divergent product preferences. Health insurance is also dominated by local regulation. In commercial and, to a lesser extent, personal lines, international diversification effects probably exist, since claims that are, for example, the result of natural disasters, are not correlated. We expect that the U-shaped scenario will be more beneficial for international consolidation of non-life insurers (with the exception of health), due to a recovery of profit margins. For life insurance we expect less international consolidation in both scenarios.

Snapshot of the Dutch market
In the Netherlands, in 2007, the health market generated approximately EUR 32 billion in GPW, more than personal and commercial lines combined (estimated at EUR 7 billion and EUR 9 billion respectively). Market consolidation is increasing over time, driven by scale advantages, especially in basic health insurance (*basisverzekering*) and commercial lines.

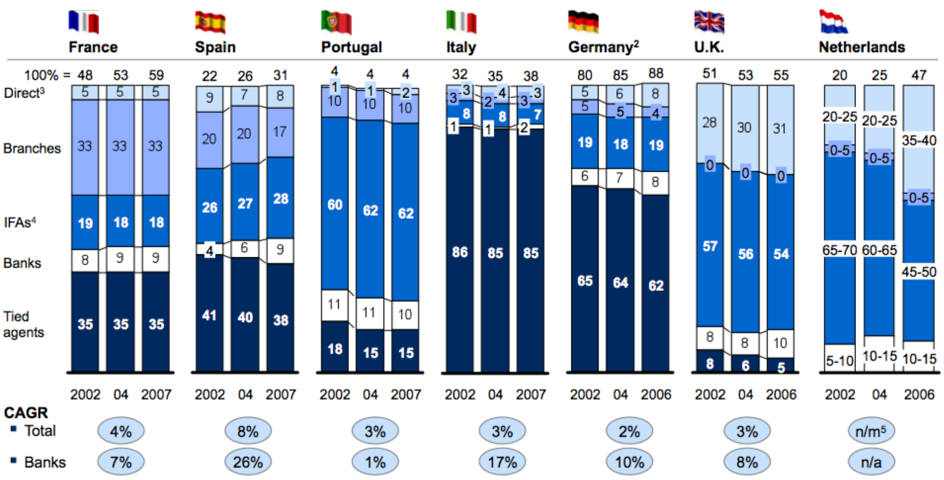
The overall competition level in personal lines seems moderate to high[21], driven by:
1) the increasing role of internet and direct players, creating transparency and ease of switching;
2) intermediaries who can easily switch their customers to another insurer.

Figure 11

Distribution of non-life insurance varies significantly across Europe

ESTIMATES

Percent of GPW[1], EUR billion



1 Gross Premiums Written
2 Excluding health
3 Including affinity and salaried sales force
4 Independent financial advisors
5 Strong growth due to privatization of health market in 2006

SOURCE: National insurance statistics; team analysis

The change in silent renewal policy will most likely lead to a higher churn rate and increasing competition. In commercial lines, competition levels are typically higher due to the presence of self-insurance and professionalization of clients in line with the European market. In health insurance, the opening up of the market in 2006 resulted in a fierce battle for customers, facilitated by the regulated basisverzekering. This resulted in a technically loss making sector (with a combined ratio of 101%)[22] in 2007. Since then, switching behavior has been decreasing. Also in health insurance, internet plays a role, with 600,000 health insurance policies sold through the internet in 2007.

While a recession leads to lower asset values and hence to lower premium volumes, profitability of the non-life insurance business is less sensitive to the two scenarios than life insurance, as contract duration is relatively short. Even so, the L-shaped scenario will lead to a longer period of decreases in premiums (personal lines, commercial lines), increases in claims (through increases in fraud and crime in personal and commercial lines, although partly offset by lower claim volumes as underlying asset values decline due to deflation) and lower investment results than the U-shaped scenario. In addition, a steep increase in inflation levels could undermine profitability in P&C, as the average maturity of P&C contracts is around 1.7 year, it would take 2 years to re-price the whole portfolio. Since health insurance is not greatly affected by economic developments, it will provide the non-life sector with an additional buffer against the effects of both scenarios.

In personal lines**,** Dutch players have an average performance compared to other European players on the critical success factors. In underwriting and pricing sophistication, Dutch players are relatively less advanced, with UK players being most sophisticated[23]. With respect to costs, while figures are not fully comparable due to differences in premium levels, Dutch players rank below the European average on the claims ratio but score slightly better on operational costs.[24]

In commercial lines**,** Dutch companies are at a competitive disadvantage in terms of scale for developing the underwriting skills needed to accept those risks that would serve the large corporate segment. However, a position in the more local standardized SME segment remains feasible. In health insurance**,** a comparison of Dutch players versus European players is not possible, due to the differences in the markets.

The Netherlands was, together with the UK, one of the first countries to introduce a direct business model and develop customer databases, with a relatively high share of 35–40% of the direct channel[25] vs. Spain (8%), Germany (8%) and France (5%) (Figure 11). The share of the direct channel strongly differs per player and business line. Internet sales are on the rise, and insurance is the second largest product in internet sales and the fastest growing online product. In 2007, more than 600.000 motor policies and around 700.000 travel and cancellation policies were sold through the internet.

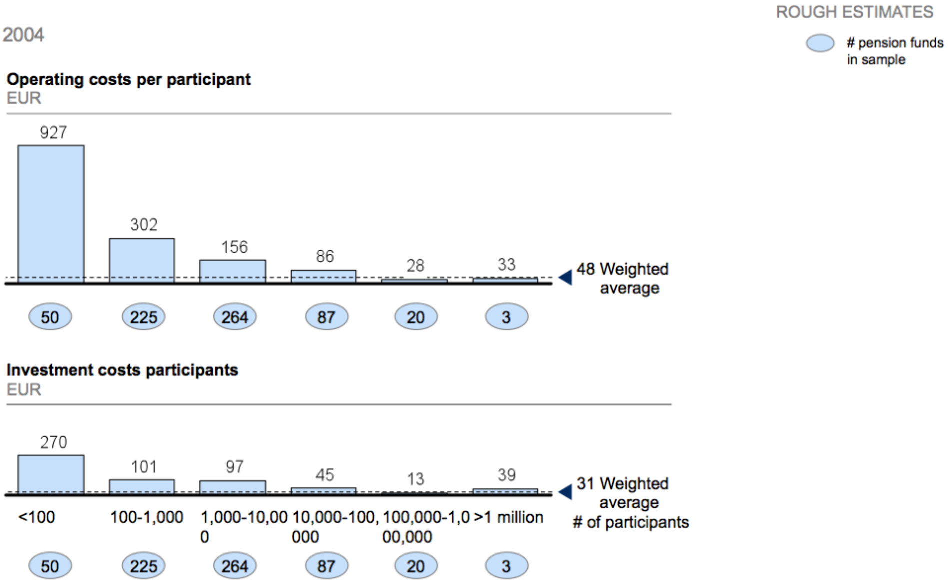
2.6 Pensions

Trends (the Netherlands)

Pension markets are fairly local, since there are large differences between countries in terms of the regulations, pillar dependency, fiscal regimes, products, IT systems and languages in which the schemes are administered. The pillar 2 group pensions are served by pension funds and insurers. In recent years, increased regulation and pressure on capital markets have forced pension funds to exit non-core activities and start a consolidation trend. The relatively high cost level of small pension plans has been one of the main reasons for the closure of around 350 smaller Dutch pension funds since 2000. We expect this consolidation trend to continue. However, to fully capture the synergies of this consolidation trend, a reduction of the number of different schemes and related IT

Figure 12

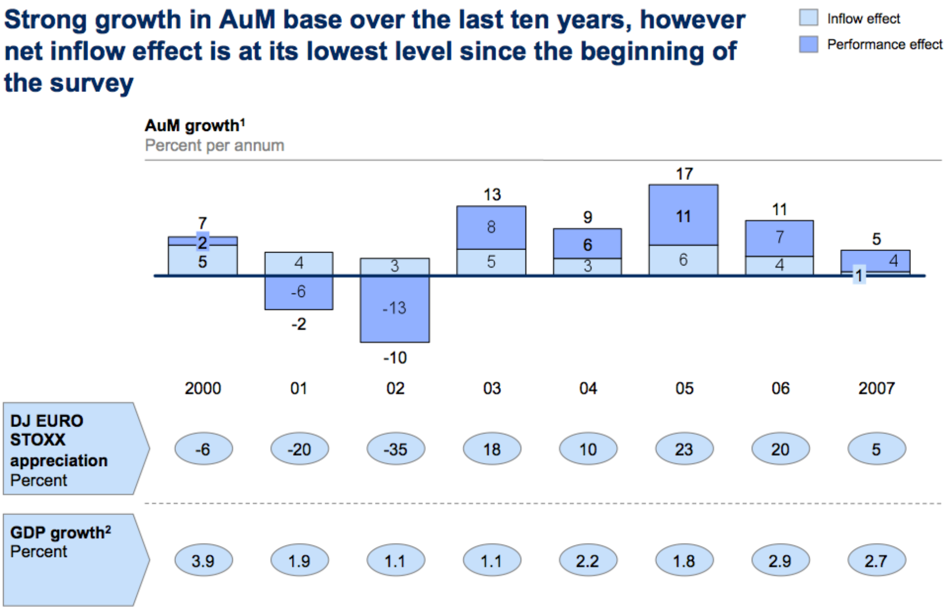
Significant economies of scale effects exist in Dutch pension sector



SOURCE: Jacob Bikker and Jan de Dreu, pension fund efficiency: the impact of scale, governance and plan design; team analysis

Figure 13

Strong growth in AuM base over the last ten years, however net inflow effect is at its lowest level since the beginning of the survey



1 Revised time series to incorporate most recent market statistics; excluding closed end funds

2 Referring to aggregated growth of Western European countries covered in survey

SOURCE: Datastream; Global Insight; McKinsey Asset Management Survey 2008 platforms would be required. Given the strong regulation of the sector and the involvement of social partners, this requires a joint effort of social partners, government, the supervisor, and the sector.

A second trend that we expect to continue is the increasing use of the services of external fund managers and fiduciary management. Fiduciary management provides a one-stop shop for pension funds for strategic advice, asset management and financial reporting. In 2008, the two largest Dutch pension schemes placed their operations in separate legal entities. These organizations manage assets for pension funds, provide fiduciary services and try to provide other insurances. The result is that they compete directly with life-insurance companies. Dutch fiduciary managers are rapidly expanding their businesses and also focus on expanding abroad in the field of fiduciary management. However, in this field they face stiff competition from several investment banks, which are building on strong commercial skills, risk-management skills and IT systems.

Snapshot of the Dutch market

The pension market in the Netherlands is well developed (EUR 719 billion AuM in 2007). Pillar 2 pension schemes comprise three types of pension funds: BPFs (industry-wide pension funds), OPFs (company-specific funds), and occupational funds. Although OPFs outnumber BPFs, the five largest pension funds are all BPFs and cover more than half the market. Pension funds extensively outsource activities along the full value chain. The most important submarkets are asset management (see section on asset management), (re)insurance (through group life contracts – see section on insurance) and administration. The administration market consists of long-term relations, in part due to switching costs that stem from the complexity of changing from one IT platform to another. In general, experts refer to the expertise and know-how of the Dutch pension sector regarding ALM and investment capabilities.

The current crisis has affected pension funds on both sides of their balance sheets: the value of their investments has diminished because of the decrease in value of equity and corporate bonds and their liabilities have increased because of declining swap rates.[26]

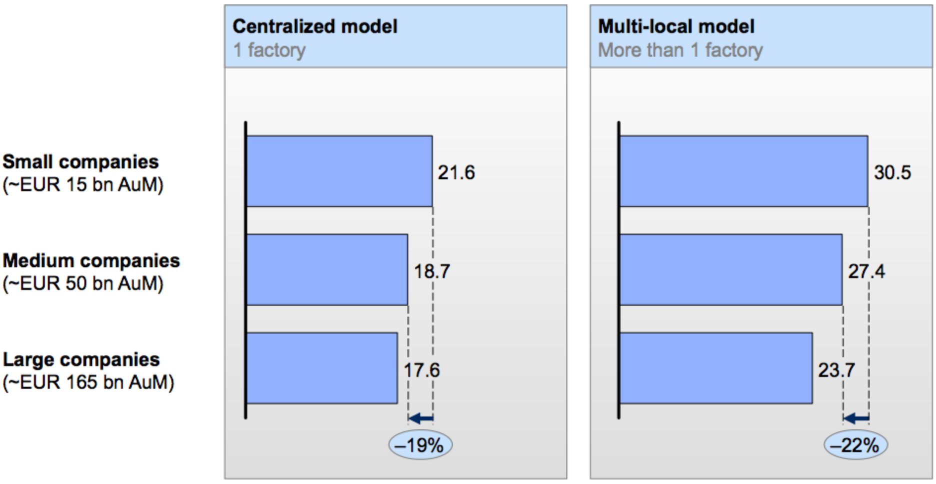
The economies of scale for pension funds are illustrated in Figure 12. Administration and investment costs are significantly lower for large funds than for small funds.[27] Several pension funds have realized reductions in costs. A look at administration costs reveals that the differences between the different types of pension fund are also large. BPFs have much lower costs per participant (EUR 33) than OPFs (EUR 138) or occupational funds (EUR 221). Some of the advantages of an OPF are that customers have control over their own pension scheme ('eigenheid') and more discretion to adjust contributions, but such benefits come at high costs when the pension fund is small. However, consolidation is a difficult process because of differences between the pension schemes regarding, for example, indexation, middle wage/end wage, build-up percentage, and the basis for pension calculation ('pensioengrondslag'). Moreover, many stakeholders are involved and ultimately the social partners ('sociale partners') make the decisions for pension funds, including decisions on consolidation.

The API ('Algemene Pensioen Instelling'), which is expected to be introduced in the coming years, might help to realize economies of scale. An API enables pension funds to cooperate and realize cost savings without having to merge their assets (which are ring-fenced). The API also provides pension funds with an alternative to liquidation and, as a consequence, having to insure the pension scheme directly at an insurer. According to KPMG research, 30% of OPFs would like to join an API. Two efforts are ongoing to facilitate this, API 1 via the 'Raad van State' and API 2 via the Ministry of Social Affairs and Employment.

Figure 14

Economies of scale exist in asset management sector

Cost margin, basis points over AuM, 2007



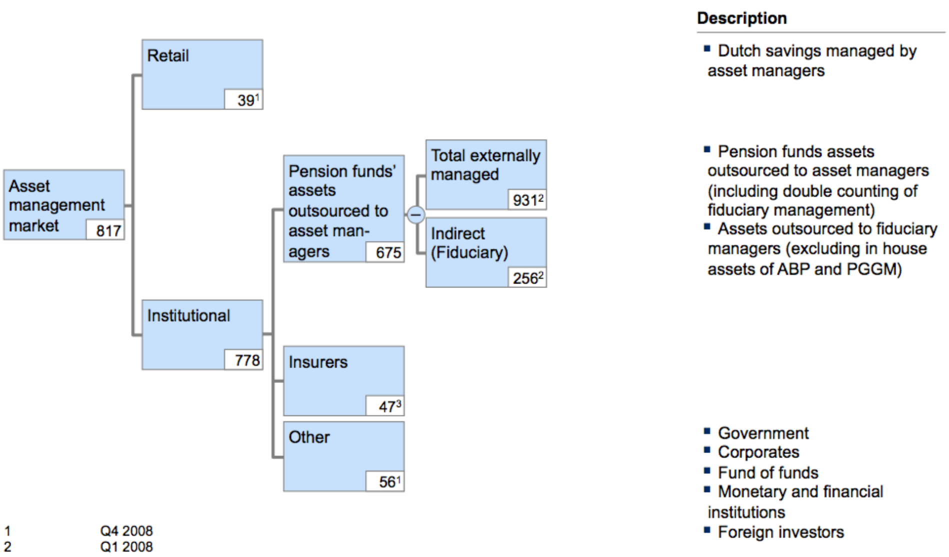
SOURCE: McKinsey asset management survey 2008

Figure 15

Third party asset management – demand from Dutch investors

ESTIMATES

2008, estimates EUR billion



1 Q4 2008
2 Q1 2008
3 Q4 2008; excluding outsourced mandates of insurers

SOURCE: Bureau Bosch; DNB table 6.3 and 6.62

2.7 Asset management

Trends (global)

Asset management was a fast-growing and very profitable market in the period 2002–2007 (Figure 13). The market can be split into a retail segment (30% in 2007 in Western Europe) and an institutional segment (70%). The crisis has led to a significant drop in profitability, driven by lower asset prices, a shift to lower-margin products and lower fee levels. As a result, a development towards an even more pronounced distinction between beta and alpha products is expected. Beta products track an index and they exhibit significant economies of scale, enabling large providers to offer Exchange Traded Funds at low cost. Given the large scale that is needed to offer these products at low cost, this space is expected to be occupied by only a handful of global players. This forces other players to focus on alpha products that seek to generate excess returns by applying an active management style. In line with the Efficient Market Hypothesis, generating excess returns over a longer period will not be feasible for a majority of fund managers. This trend leads towards bipolar consolidation with smaller alpha boutiques on the one hand and a few very large players with both beta and alpha offerings on the other hand. Figure 14 shows the economies of scale for the asset management industry.

Snapshot of the Dutch market

The Dutch asset management market is primarily an institutional market. The institutional market consists mainly of pension funds, with mandates amounting to EUR 675 billion AuM in 2008 (directly managed assets). These pension funds outsource the management of their investment portfolio to asset managers (Figure 15).[28] The retail market is smaller, at approximately EUR 39 billion.

Profits of the asset management industry will be influenced heavily by the scenarios facing the economy. In the L-shaped scenario, profitability of asset managers will decrease because of a prolonged period of negative volume effects during which it will be difficult to adjust costs. The increased demand for products with lower margins will further erode profit margins. In the U-shaped scenario, profitability is expected to pick up to normal levels through increases in volumes and a shift to products with higher profit margins. However, the high sensitivity for the scenarios of the asset management industry poses less of a risk for financial stability, because the majority of assets are 'off balance sheet', providing investors with protection. Also, there is low systemic risk because exposure to and risk of contamination of other financial institutions is typically limited.

An important trend towards externally managed pension assets has emerged in the large Dutch institutional market. Foreign asset managers have acquired market share at the expense of Dutch asset managers, but helped keep fee levels low and offer sophisticated products (for example, fiduciary management). Many pension funds have their assets managed directly or indirectly (through fiduciary management) by foreign asset managers. Foreign asset managers had a market share of 36% of total (direct + indirect market) Dutch AuM in 2008.

Dutch players have a large stake in the growing fiduciary market and they are increasing their market share. Fiduciary management has seen a spectacular growth from EUR 103 billion in 2006 to EUR 256 billion in 2008. At the same time, the share of Dutch players in fiduciary management has increased from 60% to 73% (excluding APG and PGGM in house assets). Consolidation in the institutional market continued from 2007 (top ten players covering 62% of the market) to 2008 (top ten players covering 71%[29]). In the market for directly managed assets, foreigners have a large stake. This is partly driven by the fact that Dutch fiduciary managers outsource their assets again to foreign managers.

Figure 16

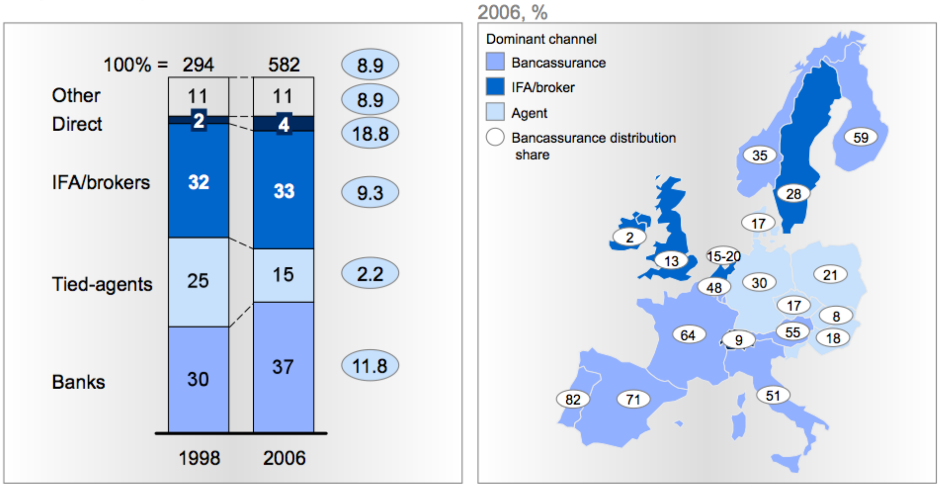
Bancassurance is the dominant channel for life insurance in Europe, with strong growth in the past years

CAGR 1998-2006

ESTIMATES

Life premiums per channel[1]
Weighted average based on GPW[2], %, EUR bn

Banking distribution shares in life domestic premiums
2006, %



1 Countries: A, BL, F, G, IT, NL, P, SP, CH, U.K., SL, PO
2 New business figures for Germany, Austria, U.K., Netherlands
SOURCE: Local statistics

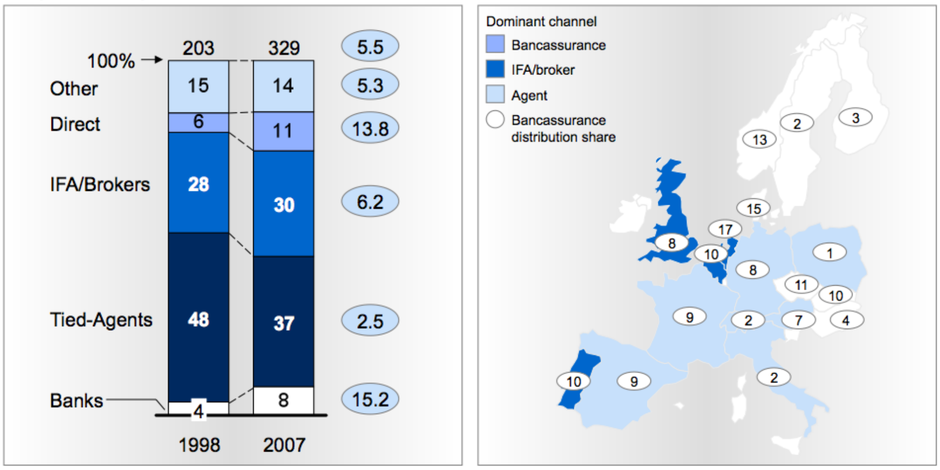
Figure 17

Tied-agents is the dominant channel for non-life insurance in Europe, bancassurance is growing quickly

CAGR 1998-2007

Non-life premiums per channel[1]
Weighted average based on GDDPW, %, EUR bn

Banking distribution shares in non-life premiums
2007, %



1 Countries: Ger, NL, F, IT, P, SP, U.K., PO
SOURCE: Local statistics

2.8 Assessment of combinations of business lines

The last two decades have seen an international trend of consolidation between *banks and insurers*. This consolidation happened in a context of traditional insurance distribution channels being under pressure from new direct and banking channels. The ensuing strategic uncertainty for insurers was one of the incentives for them to merge with banks. Banks on the other hand were looking for growth in domestic markets and were sometimes constrained by size (e.g. Benelux players). This gave rise to their interest in non-banking mergers and acquisitions. These mergers were motivated by the pursuit of business synergies from three possible sources:

1. Cross-selling of insurance products through the bank channel
   The argument of cross-selling life and non-life insurance products through the banking channel remains valid; there exist convincing examples of this distribution method. However, in the Netherlands, the majority of life and non-life insurance products is distributed by means of independent brokers (a relatively expensive distribution channel), despite the existence of some large bank and insurance combinations (Figure 16 and Figure 17). In addition, distribution synergies can also be realized by means of distribution agreements. In comparison to a distribution agreement, there may be some advantages to combining banking and insurance in one company in terms of control over the insurance activities (for example product development, or offering a segment-specific value proposition). However, with a model of distribution agreements banks have a higher degree of freedom in their international expansion, because it is easier to align with various foreign insurance companies than to match exactly the foreign expansion of the bank and the in-house insurer.

2. Costs through increased scale (primarily asset management and overhead)
   In hindsight, cost synergies were probably not fully realized: Banks and insurance companies continued to operate mostly as separate companies. This can be ascribed to the different (risk) characteristics of their products as well as cultural differences.

3. Risk diversification
   The diversification argument has become less valid in times of financial crisis such as in 2008/2009, since most financial activities have been hit.[30] The combination of banking and insurance might therefore result in an internal contagion risk. In addition, combining a large banking and insurance company may lead to additional complexities to manage.

In today's environment, banks follow diverse strategies in offering their customer base insurance products, ranging from commercial distribution contracts to joint venture partnerships with insurers and ownership for certain products. There is no single right answer here as to which model is most successful: the 'make or buy' decision depends on complexity of the product, the commercial needs, and the additional costs to offer clients choice and access to 3rd party products. Hybrid models of cooperation in distribution channels (e.g., joint ventures) and captive insurers for specific countries or product lines could still provide for viable business cases as well.

The complexity argument could also plead against combining *different banking activities within one bank*. However, here we see clear synergies. First, combining retail and mid-corporate banking makes sense because retail savings can be used to fund corporate lending. In doing so, the bank creates a maturity mismatch between short-term savings and long-term loans. To the extent that the majority of savers are not very price sensitive and the interest rate on a savings account is relatively stable, the bank can earn a relatively safe margin on this maturity transformation.[31] Second, it is possible to identify synergies between mid-corporate banking and large corporate banking, because the two customer categories will regularly ask for the same products (for example, lending, cash management, leasing) and skills (for example, risk management). Third, the large corporate segment has synergies with CMIB, since large corporate organizations are the key client group – besides financial institutions – for CMIB products. All in all, we expect that in both the U-shaped scenario and in the L-shaped scenario, banks will continue to combine banking activities within one institution. However, in the L-shaped scenario with less international cooperation, universal banks might be tempted to cut down their (loss making) investment bank activities to save costs, and spin off non-core activities to strengthen their solvency position (asset management or private banking).

The combination of *private banking with retail and mid-corporate banking* is likely to remain strong because of significant synergies. Synergies include the feeder mechanism, shared branches and operations. The McKinsey Private Banking Survey shows that in 2007, almost 70% of new domestic private banking clients were referrals from the existing retail or corporate banking network. In the other direction, retail and mid-corporate banking benefit from funding from private banking clients.

Although there are synergies between *banks and asset management* companies, banks might be tempted to spin off their asset management activities under the L-shaped scenario if they need to divest non-core activities to raise capital. We expect the combination of insurers and asset management companies to survive in both scenarios, since asset management is of strategic importance for insurance companies.

Contrary to the US, in Europe *life and non-life insurance* have been combined into so-called multiline insurers from old. This model offers some risk diversification benefits. Although such diversification could also be achieved through other means, the combination also offers synergies arising from shared technical skills, overhead costs and distribution channels. There is no clear consensus, however, about the size of these synergies.

3 Opportunities and Threats

In Chapter 1 we reviewed developments in the international financial sector. Chapter 2 assessed the current status of the Dutch financial landscape, including strengths and weaknesses. This chapter assesses three topics that could impact on development of the Dutch financial sector in the future. These are access to capital (3.1), regulatory risk management (3.2), and relevance of growth opportunities (3.3).

3.1 Access to debt and equity capital

It is likely that financial institutions will require additional capital in the next 2 to 5 years, either to deal with consequences of the crisis or to fund growth in a post-crisis financial environment with higher capital requirements. In addition, the crisis called attention to the need for financial institutions to have good and continued access to debt investors and depositors.

A longer term sustainable capital raising model requires banks to raise new equity capital without a discount to book value, requiring ROEs close to or preferably above cost of equity: this is a critical condition for the financial sector to have sustained access (as opposed to, for example, a one-time discounted rights offerings) to equity from the private sector.

Whereas expected ROEs in excess of cost of equity are a basic condition to guarantee access to equity capital from the private sector, other conditions to maintain or improve access to capital could be considered after the current transition phase. In the current crisis turmoil, the (activist) shareholder has been one of the parties blamed for the crisis. One particular statement made is that ‘short term’ focused shareholders have forced management to focus on short-term results, which has distracted management from client and risk focus. It is sometimes argued that shareholder rights should be restricted for this reason, for example through certification. Indeed, McKinsey research (Valuation, 4th edition, p. 21, 75–77) argues that management and boards experience ‘quarterly earnings pressure’ and as a result are sometimes inclined to make wrong decisions regarding short vs. long-term trade-offs to ‘please the markets’. However, the research also illustrates that investors do not primarily have a ‘next quarter’ EPS focus but a longer-term value-creation focus. Making the right trade-offs between showing good short-term performance and investing in longer-term health remains the key challenge and responsibility of management and the board. It is an open question whether restricting shareholder rights improves the quality of that process. Proposed measures to reduce shareholder rights (such as certification[32] and cross-holdings) may provide stability for the Dutch financial system but could at the same time diminish its longer-term growth prospects through a higher cost of capital and lower profitability for the sector.

Whereas so far we addressed the equity markets, it will also be important for banks to have continued access to bond markets, including hybrid financing, interbank funding, securitization markets, and retail and corporate deposits as major sources of funding. The emphasis will differ by institution, depending on their funding profile, with some banks depending more on deposits and others more on capital markets and interbank funding. In principle, access to these sources of debt funding is a function of three elements: bank solvency, investor trust in the institution, and instrument risk-return profile including guarantees. A solvent bank enjoying high trust levels will have no problem attracting retail deposits which, above all, come with a state guarantee under the Dutch deposit guarantee system. (Note that we explicitly split solvency and trust as two different factors in this equation, because the crisis illustrated how trust was more volatile than solvency).

Hybrid financial instruments emerged over the last decade as popular sources of financing for banks, were aggressively marketed by investment banks, and increasingly accommodated and acknowledged by regulatory frameworks as 'non-core' Tier-1 capital in addition to 'core' Tier-1 equity capital. Their popularity can be explained: investors regarded these instruments as 'bonds' with a higher coupon, especially for 'too big to fail banks'. At the same time, hybrid Tier-1 capital had a better price than core Tier-1 capital from the banks' perspective. The crisis has taught that the loss absorbing features (in particular in 'going concern') of Tier 1 capital instruments need to be strengthened. The recent uncertainty around the treatment of these instruments in case of government intervention could also affect investors' perception of the risk profile of these instruments and, along with that, required returns. The access to this source of funding will therefore be highly dependent on regulatory developments and the risk assessment and appetite of investors.

For securitization, the market would need to recover for banks that relied on this source of funding in case they want to maintain their business model. In essence, interviews with industry experts confirmed that the basic principle of securitization – making risks tradable – still adds value to the sector, the economy and society, but that in the future, simplicity and transparency of these instruments should be improved. The timing and extent of the recovery of securitization markets will be of crucial importance for those players whose business model depends on this source of funding, for instance mortgage providers. The liquidity of institutions which are highly dependent on securitization markets should be monitored closely.

3.2 The management of (systemic) risks

In this section, we summarize what levers could be reconsidered post-crisis for the Dutch financial sector, given its structure, the specific business lines and risks, and overall status of the sector. It is important to note that composition of the sector itself is a determinant of overall systemic risk, because the various lines of business have different economic risk profiles (indicated by their beta) and, more importantly, also contribute differently to systemic risk. These two risk aspects are not the same: for instance, investors typically perceive asset managers as risky because of a high beta of ~1.5. However, the systemic risk of asset managers is regarded as low, since they have relatively little liabilities (assets are managed for risk of client) and are of less systemic relevance than a typical bank. Similarly, investors regard life insurers also as quite risky (beta typically over 1.0) because of the long duration of liabilities and guarantees, but their systemic risk can also be considered different than that of banks: after all, banks rely on other banks and financial institutions (bond investors) for a substantial part of their funding, which poses a contamination risk to other players in the financial system. In addition, the banks' role in payments makes them much more systemically relevant. The composition of the financial sector therefore drives the intrinsic systemic risk profile of the sector.

Given a systemic risk profile by composition of the financial sector, we can summarize the three potential levers to manage systemic risks as 1) measures to strengthen resilience of individual financial institutions, 2) measures to limit the direct contamination risk and impact between institutions, and 3) systemic measures such as guarantees and measures of 'last resort'. While most measures apply to all types of financial institution, we will describe these from a banking point of view.

The first and most obvious lever is to ensure that *financial institutions remain solid, solvent and resilient at all times*. We see five important sub-levers to possibly reconsider here: corporate governance, the risk function, profitability, capital buffers, and micro-prudential regulation.

With respect to the first sub-lever, corporate governance, several recent publications have pointed out the need to strengthen the capability of the board of directors to better control and challenge banks' management. We see that putting this into practice could require the regulator to take a more active stance not just with regard to the members of the board of directors and their skill level, but also with regard to board's agenda, and how they work together. From a regulator's point of view, an effective board of directors is the first line of defence.

A second sub-lever is the independence of the CRO and the risk function, in terms of position in the organization – which, surveys show, varies substantially between banks – and responsibilities. The CRO should function independently from – and at least at the same level of authority of – any commercial function in any case.

The third sub-lever is profitability, since profits are important for sustaining and improving the soundness of the financial sector. Therefore, ensuring profitability by, for example, stimulating operational efficiency could be considered a priority for the sector.

The fourth sub-lever, strengthening of capital buffers is an obvious one to consider. This could be achieved by the introduction of a harmonized maximum leverage ratio (the ratio of debt and equity). Another important consideration in this regard is to build higher reserves in good times.

Finally, the crisis also showed that micro-prudential regulation could be improved: one action would be to apply stress tests consistently across the sector; another would be to improve attention for liquidity management measures.

The second lever for managing systemic risk is *limiting contamination risk and impact*. Three potential sub-levers are: macro-prudential supervision, institutional measures, and measures related to institution size.

On the first sub-lever, the crisis showed that a single event can affect the sector as a whole, rather than just one institution: several institutions were directly hit by the subprime mortgage crisis, either through their Alt-A holdings or CDOs in their portfolios. This illustrates the need for effective macro-prudential oversight, in order to ensure proper assessment and diversification of risks at a macro level.

On the second sub-lever, institutional measures, we see potential along the lines of 'branch vs. subsidiary' and legal measures to limit contamination risks within and across institutions. However, the real effectiveness of such measures in light of reputational risk needs to be considered: will such measures hold in crisis circumstances, or will reputation risk still require a bail-out? Finally, on the third sub-lever one could consider measures related to size of the financial institution. Although such measures could be effective in limiting impact of contamination, the impact of these size-related measures also needs careful consideration for example in terms of a competitive positioning of Dutch-based financial institutions and enforcement.

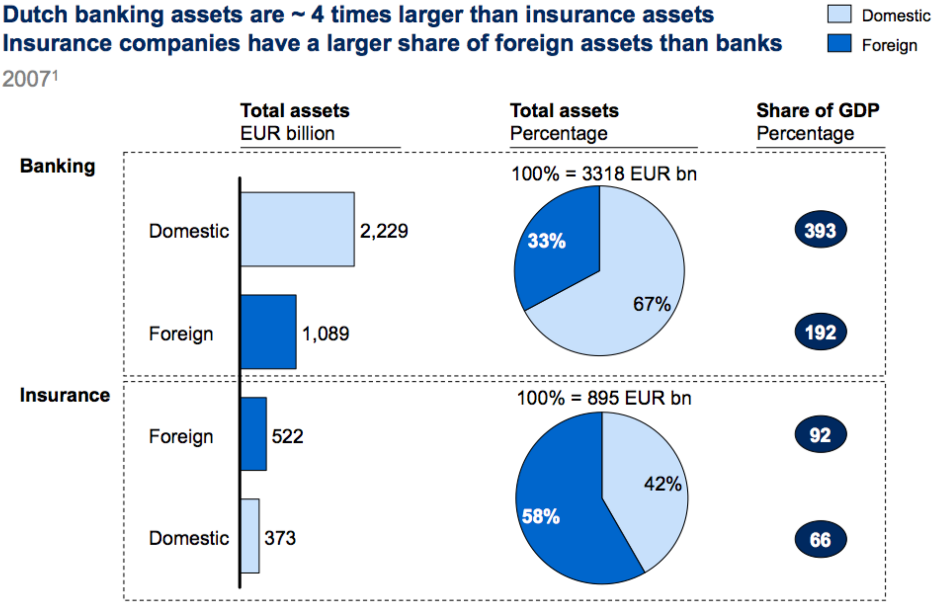
The third lever is *systemic measures and measures of last resort*. This comprises at least three sub-levers: the Dutch deposit-guarantee system, European burden sharing, and the 'crisis toolkit'. The Dutch deposit-guarantee system has been modified during the crisis, with guarantees lifted to EUR 100,000 for consumers. Although this has helped restore confidence, it has also encouraged both Dutch and foreign financial institutions to actively attract deposits using this state guarantee, in some cases to fund credits with a relatively high risk profile. A review of this system is therefore currently under way.

A second sub-lever to reconsider is a system of (irrevocable) European burden sharing, which would benefit especially smaller and mid-sized countries such as the Netherlands

Figure 18

Dutch banking assets are ~ 4 times larger than insurance assets
Insurance companies have a larger share of foreign assets than banks

2007[1]



1 Domestic vs. foreign split in banking based on domestic vs. consolidated balance sheet of registered credit institutions. Split for insurance based on foreign assets of 4 large insurers compared to domestic assets according to "verslagstaten"

SOURCE: DNB; Annual reports; CBS

with (still) relatively large financial institutions. A 'back-stop' system where Europe shares only part of the loss or absorbs losses above a certain limit could help avoid a moral hazard issue because it would still leave a strong incentive for the local government and regulator to avoid losses. Though perhaps not feasible in the short term, such a system would benefit countries such as the Netherlands with a relatively large financial sector compared to its GDP (Figure 18).
Finally, the crisis has also demonstrated the need for an effective 'crisis toolkit' in order to operate effectively and swiftly during times of crisis.

So, what are the specific issues from the above mentioned three levers for the Dutch financial system? First, while all will require careful consideration, size-related measures would certainly require attention, given that the Netherlands has a number of large financial institutions (in relation to Dutch GDP). Currently, foreign assets of Dutch financial institutions – as the chart shows – already account for EUR 1.5 trillion. Growth and healthy profitability are the main sources of value creation of companies (including financial institutions).[33] Value creation is key in maintaining a high share price necessary to maintain independence for large, publicly listed institutions over time. For all institutions, revenue growth is a necessary input for maintenance of market share, whereas stable earnings growth is a prerogative for a strong credit rating. For banks, growth of the loan portfolio requires capital regeneration, which must also be fed through earnings growth. Given a finite home market, this implies growth beyond national boundaries for many institutions, depending on the nature of their activities. This raises questions of how the government and regulators should deal with the risks that this foreign growth tendency brings to Dutch society – for instance, through the Dutch deposit guarantee system – and whether these risks can be sufficiency managed or mitigated. Besides understanding these risks, it is important to assess the opportunities and benefits that accompany a growing financial sector, in order to make a well-founded risk/return trade-off.

3.3 Relevance of growth opportunities

Despite risks inherent to the financial sector as described in the previous section, the financial sector remains a substantial contributor to Dutch GDP (~6.5% in 2007), with potential for further growth. History shows that even severe economic downturns are followed by economic upswings. A well-functioning financial sector would be instrumental in supporting such an upswing. Therefore, while the current imperative is to focus on the effects of the crisis, it is important that both authorities and the sector keep a long-term perspective when evaluating policy actions. This section provides perspectives on the relevance of growth of the financial sector both for the Dutch economy and for Dutch financial institutions.

When considering relevance of growth of the financial sector for the Dutch economy, it is important to distinguish between the Dutch financial sector (including foreign players operating in the Netherlands) and financial institutions of Dutch origin. Countries like Luxembourg and Switzerland have developed into 'clusters' for fund administration and private banking locations for banks from across the globe, benefiting their economies, their skill levels, and their competitive position in these types of financial service. Such examples demonstrate how in principle real economic growth is driven by competition in a fair level playing field and how the introduction of foreign banks might help enforce more efficiency, innovation, productivity growth and therefore GDP growth.

Developing a Dutch financial centre that looks beyond the origin of banks, should therefore be considered as a separate lever besides developing international financial institutions of Dutch origin with headquarters based in the Netherlands. Nevertheless, several studies also point out the relevance and economic benefits of having international headquarters in the Netherlands. Besides job creation (a BCG report from March 2008 estimates that the headquarters of the 16 largest Dutch firms are responsible for 135.000 jobs), having own financial institutions is beneficial to domestic credit markets in the current crisis, and this benefits the economy. Below, we consider both aspects – jobs and credit. Other aspects, such as the international influence generated by the existence of a large financial sector, can also be considered, but are harder to quantify.

- *Jobs*: One can debate the number of jobs that would actually disappear in the event of a foreign takeover of a Dutch financial institution. Many of the headquarters' jobs are related to domestic activities and cannot be easily shifted abroad due to differences in products, legislation, legacy systems, etc. In light of this, it could be useful to assess how many jobs at Dutch financial institutions have been created by their foreign activities: managing a cross-border concept in banking (for instance in retail banking) requires effort and coordination from headquarters and has likely resulted in relevant job creation, depending on which activities are conducted at headquarters on a global basis (for example strategy, marketing, IT, finance). However, acquiring foreign banking operations and acting as a shareholder or holding company is likely to have resulted in much less job creation.

- *Credits*: A relevant example in this context is that the Bank of England has recently reported a relative decline in lending from foreign institutions to British corporations.[34] Also, several banks have recently announced the intent to retreat from foreign (emerging) markets. However, it is unclear whether this is caused by an intent to focus scarce capital on markets considered 'core' (for example, based on having a critical market share) or on markets with less of a currency, interest rate or business cycle risk.

1 The HHI for Dutch mortgage market is 1460 and for the savings market 2366. HHI (Herfindahl Hirschman Index): Markets in which the HHI is between 1000 and 1800 are considered to be moderately concentrated, those with an HHI in excess of 1800 are considered to be concentrated.
2 DNB projects -5.4%, CPB -4.75% (June 2009).
3 For stock market returns, the scenarios differ also in 2009, since stock market performance tends to lead economic recovery.
4 'Eenvoud herstelt vertrouwen', Marketing Tribune, 28 april 2009.
5 In the Netherlands for example, the big banks had a lower share of wallet between 2000 and 2005, and the number of banking relationships per consumer increased.
6 Based on the average interest on new mortgages provided by Dutch banks minus the rate of the 10-year government bond.
7 The HHI (Herfindahl Hirschman Index) for the Dutch mortgage market is 1460, and the HHI for the savings market is 2366. Markets in which the HHI is between 1000 and 1800 are considered to be moderately concentrated, those with an HHI in excess of 1800 are considered to be concentrated.
8 Based on 2006 McKinsey publication 'Betalingsverkeer in Nederland:een onderzoek naar de opbrengsten en kosten voor het bankwezen'. EU 15 estimate based on McKinsey global banking profit pools excluding Luxembourg, including Norway and Sweden.
9 Based on research by Worldwide Independent Network of Market Research (Jan 2009) and the Reputation Institute from the Erasmus University (Rotterdam).
10 Incidentally, the introduction of SEPA might also reduce the need for cross-subsidizing the loss-making payment services. According to Schmiedel ('The economic impact of the single euro payments area', ECB Occasional Paper, no. 71, 2007), SEPA could lead to a convergence of European fee levels for payments.
11 Average score in 2008 6.6 for mortgages and 7 for savings on a scale from 1 to 10.
12 Mid- and large corporate banking encompasses straight and syndicated loans, cash management (consisting of payment services and more advanced services such as netting, pooling and sweeping) and specialized finance such as leasing, factoring, trade finance, project finance and structured loans for mid-corporates (EUR 2.5–250 mln revenues) and large corporates (over EUR 250 mln revenues).
13 The goal of SEPA is to create a single payment platform in the EU (in euro, so in practice it applies to the eurozone). The system encompasses a harmonised method for payments transfers (which is already functioning), direct debits and payment cards. The introduction of SEPA might have a somewhat stronger effect on corporate banking than retail banking, as trust – which is harder to achieve in foreign banks – is more important in retail banking.
14 CMIB encompasses a variety of relatively high risk activities, like underwriting issuance on equity and debt markets, M&A advisory, trading, proprietary trading and principal investments (private equity).
15 2006 CMIB revenues are estimated to be approximately EUR 3.6 billion.
16 The HHI index for the Dutch life market is 1364.
17 NBM is an indicator of the profitability of new business measured by the present value of future profits of new policies sold divided by the present value of future premiums of new policies sold.
18 According to a survey of the Consumentenbond, cost loadings of unit linked Banksparen products are significantly lower than on insurance products.
19 Personal and commercial lines consist amongst others of motor, property, liability and accident insurance products.
20 NPV of announced synergies as percentage of deal value.
21 The HHI of the combined personal and commercial lines market is 928.
22 The combined ratio equals expenses and losses divided by revenues from premiums.
23 According to the McKinsey Pricing Capabilities Survey.
24 Claims ratio is 74%, significantly worse than countries like the UK (69%) and Germany (70%). The expense ratio (operational costs) is 24%, corresponding to a fifth position among a sample of 11 countries from 2000-2005. These figures are including commercial lines, since separate figures for personal lines and commercial lines are not available.
25 Including the so-called alternative channels, such as retailers and car dealers.
26 Liabilities have to be discounted through the swap rate according to the rules of FTK.
27 Bikker and de Dreu (' Operating costs of pension funds: the impact of scale, governance and plan design', Journal of Pension Economics and Finance 8, 2009) estimate that an increase of the pension fund size by 1% raises administrative costs by only 0.59%. The coefficient between pension fund size and total investment costs is 0.86.
28 Excluding fiduciary managers.
29 ~ 67% if corrected for APG and PGGM effect.
30 The exceptionally severe crisis of 2008 is not representative for other crises. However, buffers are should be sufficient in the most severe stress-scenarios.
31 This business model could be threatened by indications that savers have become more sensitive to the interest rate offered by banks (see also paragraph 1.2.1 about retail banking).
32 For the Dutch market, Roosenboom and Van der Groot (The effect of ownership and control on market valuation: Evidence from initial public offerings in the Netherlands, International Review of Financial Analysis, 2005) found a significant negative relation between use of certificates and IPO firm value.
33 McKinsey research ('The granularity of growth') points to the relevance of both organic and inorganic growth for the survival of companies.
34 Bank of England: Trends in Lending – April 2009.