POLICY BRIEF

NEDERLANDSE FINANCIERINGSINSTELLING VOOR ECONOMISCHE ONTWIKKELING (NFEO)

A VIABILITY ASSESSMENT

ACKNOWLEDGEMENTS

This policy brief is a synthesis of the analysis, insights, and ideas of many individuals in the public and private sectors in the Netherlands. It was prepared inter alia at the invitation of VNO-NCW. The team from Oliver Wyman and De Brauw Blackstone Westbroek is grateful to all who contributed their time and effort to provide guidance and support in the writing of this policy brief. We particularly would like to thank interview partners across government, industry and academia listed in Appendix J of the report. This policy brief builds on the paper written by Jeroen Kremers at the invitation of the Committee on Economic and Social Affairs of the Economic and Social Council, and provides detail on analyses and recommended results. The policy brief and accompanying report should serve as a starting point for the discussion to create NFEO. It is not intended as a lobby exercise. We would like to invite others to join the debate on the merits of NFEO and how such an institution can be best implemented.

AUTHORS

The views expressed in the policy brief and report are the responsibility of Oliver Wyman and De Brauw Blackstone Westbroek. Oliver Wyman and De Brauw Blackstone Westbroek have jointly written the following sections of the policy brief: Executive summary, Introduction, 6. Implementation and timeline.

Oliver Wyman is the sole author of the following sections of the policy brief: 1. Mandate, 2. Institutional model, 4. Alternative portfolio structures and financials.

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EXECUTIVE SUMMARY

The Netherlands is one of the few countries in the European Union that does not have a broad spectrum public bank devoted to economic development – or a National Promotional Bank/Institution (NPBI), as we will call it for the purpose of this report. Today, the government offers a range of promotional schemes managed by three predominantly publicly owned banks and several other public entities. The Netherlands is now considering creating an NPBI with a broad mandate.

WHY AN NPBI IS NEEDED?

Development banking in the Netherlands is fragmented across three main entities - the Bank Nederlandse Gemeenten (BNG), the Nederlandse Waterschapsbank (NWB) and the Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden (FMO) - and a number of governmental promotional schemes, some of which are managed by the Rijksdienst voor Ondernemend Nederland (RVO).

> *"A broad spectrum promotional bank focused on strategic investments could function as society's financing back office. Such an institution would be able to mobilise funding from private institutions such as pension funds and insurance companies"*
>
> **Cees Oudshoorn, General Director, VNO-NCW**

This fragmentation makes it difficult to offer expertise and improve access to financing and capital to those sectors in the Netherlands which have a need for it. There is evidence of un-met financing demand for small and medium-sized enterprises (SME) and innovation, energy and climate financing and international investments and exports, with government support lagging behind European norms and domestic ambition.[1] Moreover, fragmentation is creating operational and funding inefficiencies: banking is a "scale business" with high fixed costs, and therefore fragmentation increases (unit) operating costs and leads to an inefficient allocation of funding since each entity has an interest in directing money to its own borrower class. We see six key benefits of consolidating this landscape, which would help to overcome these challenges:

1. **Resolve fragmentation:** Better coordination between promotional activities in the most comprehensive manner. This will reap synergies between existing activities within institutions (e.g. alignment between promotional schemes offered through RVO), within industries (e.g. coordination of international development and export schemes for SMEs between FMO and RVO) and between industries (e.g. export finance solutions to allow SMEs extend their reach and grow) to increase impact.
2. **Bundle expertise and advocacy:** Scattered expertise around various promotional activities can be brought together to improve clout and address a demand for advisory services. Key functions like risk management and treasury as well as financial structuring can be moved to best-in-class, and scale is created to allow for high quality research and advocacy on promotional activities. In addition, we have observed in other consolidated NPBIs that it becomes easier to attract expertise and high quality personnel from the private sector. Finally, market failures can be complex and have very

[1] Refer to Section 1 for further sources regarding the market challenges described.

different causes. There is a need for independent evaluation, based on data and research which an NPBI can provide to get to factual representations.[2]

3. **More impact:** Development of more integrated financing solutions by increased flexibility to deploy all available instruments (financing, direct investment, guarantees) and allowing trade-offs around what instruments can best be offered in which situation without biases. Also such a combined mandate would allow a focus on *structurally resolving* the underlying reasons for market failure, e.g. through establishing platforms or closing information gaps where they occur.
4. **Financial benefits:** Synergies of scale and funding are estimated to reduce cost by approximately €120 MN annually, partially depending on the extension of a state guarantee. These funds will be beneficial for (national and local) government finances and can be reinvested in promotional activities and levered to attract significant further private sector co-investment. Also, consolidation would ensure adherence to capital constraints due to complementary balance sheets between the entities in terms of capital and liquidity, freeing up about €2 BN of capital on combination. The addition of synergy benefits and the possibility to divest social housing can bring total free capital to €3.2 BN over the next 5 years.
5. **Strengthen governance and transparency:** Defragmentation would increase transparency by providing a focal point for scrutiny of the government's role in development finance, ensure it remains rigorously focused on market failure and avoid crowding out the private sector. Also, it would be easier to ensure sound and controlled business operations across promotional activities in the Netherlands, in line with best practice internationally.
6. **Central counterpart for EU initiatives:** Improved access to EU and international funds by creating an obvious national contact and counterpart for European partner organisations.

WHAT WOULD ITS STRUCTURE AND MANDATE BE?

From different constellations investigated, we believe the most effective way to achieve these benefits is to combine the current entities – BNG, NWB, FMO and selected schemes – to create one Dutch NPBI, the Nederlandse Financieringsinstelling voor Economische Ontwikkeling (NFEO). This would bring together current promotional activities under one roof, avoiding overlaps and allowing mobilisation behind gaps in current activity. Although examples of more sector-specific setups exist, with entities focusing on one or more of the arms mentioned in e.g. the UK, these models fall short in terms of achieving the full financial and non-financial benefits mentioned above. We argue that such a split end-state should not be the ambition level for government action in this area.

"The public financing instruments for SME/innovations, energy and climate, and international exports and investments are hampered by fragmentation. A new public financial institution encompassing and enhancing these instruments could be a huge improvement, and help reap synergy benefits between these fields. Provided the institution's mandate and governance is rigorously focused on market failure, the institution will be additional to the market and well-placed to partner with the banks."

**Koos Timmermans,
Member and Vice-chairman of
the management board, ING**

[2] A good example in the SME segment of the type of research and fact base referred to is the independent lending review performed in the UK, which established a factual background after a perceived lack of SME lending by RBS: http://www.independentlendingreview.co.uk/index.htm

The proposed consolidated set-up would also not require additional equity to be contributed by the state. The current balance sheet makeup of the various entities is inefficient, as it creates a lot of trapped capital and to get to a leverage ratio of 3% BNG and NWB have been forced to commit to retain €1.2 BN over the coming years. If the entities are consolidated, the combined balance sheet would have a CET1 ratio of 26% and leverage ratio of 3.4%, which means that there is €0.8 BN of free capital above reasonable minimum constraints of a 20% CET1 and 3% leverage ratio. Thus compared to the current structure a total advantage of €2 BN is created. Free synergy benefits over the next 5 years and the possibility to divest the social housing portfolio could create a further €0.5 BN and €0.7 BN of free capital respectively, bringing total free capital to €3.2 BN. The exact capacity for additional lending this could generate is dependent on the risk associated with that lending, but if an RWA density of 66% is assumed this would create more than €24 BN of additional lending capacity for the combined entity. If we include partnerships with the EIB, crowding in from the private sector, and a transfer of some energy subsidy funds to financing, we feel comfortable that more than €100 BN of financing capacity can be generated.

NFEO should play a complementary role to the private sector, focusing only on addressing market failures. This mandate should evolve over time, as new market failures arise and others cease to exist. NFEO aims to be a professional financial institution, not a government department. Strong and disciplined governance will need to be in place to ensure adherence to this mandate, as well as regular internal and external evaluation of the institution’s activity spectrum. A strong central research function within the institution should facilitate this evaluation process.

Given the current promotional landscape, NFEO would be structured to reflect a focus on three arms of activity (Small and Medium-sized Enterprises and Innovation, Energy and Climate Financing, International Investments and Exports) which are brought together under one roof in a federated model to ensure effective cooperation, while ensuring sufficient autonomy.

HOW COULD IT BE SET UP?

NFEO could be organized in the legal form of a Dutch public limited liability company; an N.V. The shares of NFEO could be owned by the current shareholders of the constituting entities, with the Dutch State as the majority shareholder.

Separating BNG’s and NWB’s social housing activities is recommended. Although undeniably socially useful, the overlap of social housing with the other arms within NFEO is limited and excluding it would bring the size of the institution proportionally more in line with international practice. Private sector investors are already investing in social housing – sometimes at cheaper rates than BNG and NWB – and bundling these activities would increase attractiveness for private or institutional investors.

> *"Leadership and action are needed from The Hague now in supporting startups, scale-ups, innovative projects and energy sustainability. Otherwise we miss a big chance for jobs and economic growth. The market cannot do it alone. Certainly not in sectors like high-tech where time to market can be long."*
>
> Staf Depla,
> Alderman Eindhoven and
> Chairman of Finance Committee
> VNG

In terms of governance, NFEO should strike the right balance between, on the one hand, a professional financial institution, operating at arm's length of the government in order to avoid being considered a captive government department for EMU consolidation purposes, and, on the other hand, sufficient influence of the government on NFEO's policy.

NFEO should be backed by a guarantee from the Dutch State, in line with many promotional banks internationally, and as currently already in place for FMO. This would replace the implicit guarantee which arguably exists already for BNG and NWB and, given a significant portion of assets already guaranteed, would not fundamentally alter the risk profile of the state. An explicit guarantee will make promotional banking cheaper due to funding benefits.

Generally, NPBIs do not impact the state's balance sheet. The state guarantee would not be included in EMU debt as it is considered a contingent liability. Nor would the debts of NFEO be included in EMU debt provided the governance and operations of NFEO are structured in a manner that is sufficiently independent from the government and thus avoids that NFEO becomes a captive financial institution.

Including parliamentary support for the plan, the first steps in establishing NFEO – namely, incorporation and establishing the governance of the NFEO group and start of integration – could be achieved in 4-6 months. The second step, bringing FMO, BNG, NWB and the schemes under one roof, could be completed in another 6 months. Integrating the business could be achieved within a further 12 months.

* * * * *

All in all, we consider the establishment of a broad-spectrum NPBI viable and believe it is legally, operationally, and financially feasible. We believe the government should aspire for a comprehensive and high quality solution to the long list of coordination problems and inefficiencies in the current promotional landscape by establishing NFEO as consolidated NPBI.

This policy brief is accompanied by a more comprehensive report, which provides detail on analyses and recommended results. The report should serve as a starting point for the discussion to create NFEO. We would like to invite others to join the discussion on the merits of NFEO and how best such an institution can be implemented.

INTRODUCTION

Development banking in the Netherlands is fragmented across three main entities and several governmental promotional schemes, some of which are managed by the Rijksdienst voor Ondernemend Nederland (RVO). The Bank Nederlandse Gemeenten (BNG) primarily finances public sector entities, social housing corporations and health care institutions. The Nederlandse Waterschapsbank (NWB) predominantly lends to social housing corporations, water authorities, municipal authorities and healthcare institutions. The Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden (FMO) provides loans and advisory services to private sector clients in developing countries with a focus on financial institutions, energy companies, and agribusinesses.

"As a result of fragmentation in the Netherlands, it can be more of a challenge to provide technical assistance (e.g. structuring investment platforms) from the European level"

"A broad spectrum National Promotional Bank establishes credibility and could be a catalyst for investments"

Benjamin Angel,
Director 'Treasury and financial operations', European Commission

Discussions concerning the creation of a Nederlandse Financieringsinstelling voor Economische Ontwikkeling (NFEO) were initiated by the Ministers of Economy and Finance when they commissioned a position paper from the Netherlands Investment Agency (NIA). The paper argued for transforming the NIA into a new National Promotional Bank/Institution, inspired by the German Kreditanstalt für Wiederaufbau (KfW) but attuned to the Dutch economy and leveraging best practices from other Promotional Banks internationally.[3] This was reinforced by the European Commission's 2015 recommendation that countries without a broad NPBI should create one,[4] as for example Croatia and Portugal have recently done.

This policy brief and the underlying report, prepared by Oliver Wyman and De Brauw Blackstone Westbroek, explore the development of NFEO. Its aim is to explain how such an entity should be established and to make a *prima facie* case for it (which should be subject to subsequent due diligence). The majority of stakeholders we interviewed in the process of elaborating this policy brief agreed that the Netherlands would benefit from a broad spectrum institution devoted to promoting economic development.

This policy brief outlines a mandate for such an entity and assesses alternative institutional models. For the preferred model, it then suggests a governance structure and describes the expected financial implications, building on best practices from NPBIs internationally. The final section provides a potential roadmap for implementation.

The accompanying comprehensive report provides further detail on the recommendations and supporting analyses. These are based on public, outside-in information and interviews with more than 70 stakeholders across government, industry, and academia.

[3] Nederlands Investerings Agentschap voor EFSI: Opstart en verdere vormgeving, NIA, October 2015

[4] "Working together for jobs and growth: The role of National Promotional Bank/ Institution (NPBIs) in supporting the Investment Plan for Europe", European Commission, July 2015

1. MANDATE

> "The governance of NFEO should be convincing and guarantee strict dedication of this new institution to alleviating market failure. This means its activities will be additional to the market, moreover it will strive to help create market solutions. In this sense, NFEO would be best in class."
>
> Jarig van Sinderen, Chief Economist, ACM

The total or "social" benefits of some endeavours far exceed the private benefits to those undertaking them. The construction of infrastructure is a classic example. Yet, in a purely commercial market, the cost of financing these endeavours must be paid for from the private benefits alone. Such endeavours thus receive less than the socially optimal amount of funding. State-owned NPBIs aim to address such market failures.

Several entities already operate in the Netherlands to address such market failures.[5] The proposed NFEO will consolidate their mandates and achieve the benefits arising from improved coordination and scale.

Over time, this mandate can evolve from this starting point as new market failures arise, and others cease to exist. As such, NFEO should be guided by at least the following principles:

- Promote regional, national and international economic development.
- Focus on areas of observable market failure.
- Play a role which is complementary to the private sector (i.e. avoid crowding out the private sector and incentivise private sector investment by shifting the risk/return profile of investments).
- Operate within the limits of financial sustainability (i.e. conduct promotional activities at a level which is financially viable).

Strong and disciplined governance will be required to ensure adherence to these guiding principles, as will an operational model which keeps NFEO's management at arm's length from the government (see Section 3).

NFEO's target customer segments would follow from these guiding principles and evolve over time as economic conditions change. As things stand in the commercial market, NFEO would start with a focus on three areas, building on activities already performed by the Dutch development banks and the government today:

1. Small and Medium-sized Enterprises (SMEs) and innovation

   The activities of SMEs may generate considerable "positive externalities" (benefits that accrue to members of society other than the owners of the business). They can be more innovative than large companies and create more jobs. Yet they often find it difficult to raise finance because they present lenders with more risk than large companies with more predictable profit streams, do not have the same reporting standards as larger companies and often cannot offer high quality collateral. NPBIs thus often extend guarantees or financing to SMEs.

[5] Refer to Appendix C of the full report for a list of promotional schemes

In the Netherlands, SMEs and innovation are supported through a large number of schemes offered by the government (mainly through RVO), regional private equity investments, and some direct investments from the EU. Arguably, indications for market failure in this area are found in high rejection rates for SME credit applications[6] and significant unmet funding needs.[7]

Combining these promotional activities under one roof should deliver improvements:

- It eliminates the tunnel vision of current schemes, that are commonly established for a single purpose and operate only within that mandate. A combined mandate enables trade-offs concerning the best instruments to be used (guarantees, financing, equity investments) and allows the already available funds to be routed to the most important areas.
- Scale allows the concentration of expertise. Many of the activities of a NPBI aimed at structurally resolving market failures – such as establishing SME platforms, SME credit rating agencies,[8] or working with crowd-funders to change the fundamental risk/return profile of the market – require dedicated effort and central expertise.

2. Energy and climate financing

Sustainable energy and climate projects often experience difficulty in attracting sufficient funding. We believe there are two main factors that drive this:

- Firstly, the private sector does not take the relatively large external benefits of sustainable energy and climate investments into full consideration. The commercial mindset values direct financial returns above potentially positive externalities;
- Secondly, banks and investors are reluctant to finance these investments at terms that borrowers consider reasonable. These projects often require very long term financing, while banks themselves are funded primarily by short term deposits. This creates a large "mismatch" or liquidity risk for banks, which makes them reluctant to lend except with a large "risk premium" on the rate they charge. In addition, the risk premium is significantly driven by risks associated with changes in government policy (e.g. altering subsidy schemes), which can negatively impact returns and expenses.

> *"To more broadly develop sustainable energy technologies and plants at a more rapid pace, the Dutch government should stimulate the availability of mezzanine financings and co-investments, next to or in lieu of existing subsidy schemes, as it would increase market discipline, lead to more efficient use of (public) financial resources, and create a more integrated approach to address the energy system challenges ahead."*
>
> Otto Jager,
> CFO TenneT

The Netherlands is currently lagging behind other countries in achieving climate goals set on global, European, and national levels, and in the effort to become less dependent on fossil fuels. According to the International Energy Agency, the share of primary energy production from renewables and

[6] At 25%, Dutch banks' rejection rates for SME credit applications is the highest in the Eurozone, followed by Ireland (17%) and Greece (16%). The Eurozone average is 7%. "Survey on the access to finance of enterprises in the euro area (SAFE) - October 2014 to March 2015", European Central Bank, June 2015

[7] The Social Economic Council estimated the total funding requirement of SMEs in the Netherlands in 2014 to amount to €23 BN. In the previous year, only 73% of the funding requirement was met. "Verbreding en versterking financiering MKB", Sociaal Economisch Raad, 2014

[8] As e.g. recommended by the OECD in their March 2016 economic surveys: "OECD economic surveys NETHERLANDS," March 2016, page 5.

waste is only 6% in the Netherlands, significantly below the share in other European countries, such as Norway (44%), Sweden (36%) and Germany (13%).[9] With a 2016 budget of €8 BN annually in governmental subsidies (SDE+) for sustainable energy a significant challenge has been recognised,[10] and calls for further public investments in sustainable energy exist.[11] To meet European standards and achieve government objectives, the Netherlands will need to invest heavily in sustainable energy production capacity and its energy infrastructure (such as grid infrastructure upgrades and energy-efficient homes).

As part of the goals outlined in the Dutch energy accord (Energieakkoord), a large number of tenders have been approved in conjunction with the main subsidy instrument SDE+. Given current low energy prices, it is expected that this instrument is approaching its obligation ceiling of €18 BN.[12] If energy prices remain low in the foreseeable future, the functional limit of this subsidy instrument could well be reached soon and thus limit support for new innovations.

In addition, investments in the sustainability infrastructure (e.g. energy grids) are needed. Between 2012 and 2015 the required annual investment in electricity grids is estimated to have doubled to €2 BN, and investment is expected to remain high in the coming decades.[13] An estimated €20-71 BN of investments is required for electricity grids and gas networks until 2050.[14] Sustainability investment in residential buildings and district heating is also expected to remain significant in the years ahead. Finally, significant investment will be required to improve the energy efficiency of residential buildings mainly through energy service companies (ESCOs).[15]

"Huge investments are needed for energy and climate, across the broad range from energy generation through network infrastructure to energy efficiency and innovation. These are long-term investments within an environment of uncertainty about both market developments and government policies. Instead of relying only on subsidies, a "KfW-like" public financial institution to co-finance such investments could help reduce market failure and promote government energy policy that is consistent over time."

Pieter Boot,
Planbureau voor de Leefomgeving

The Dutch economy has over time built up a specialisation in activities reliant on hydrocarbons, be it through the refinery or chemical activities in Pernis or through glas houses heated by gas. The transition to a sustainable energy economy is therefore a larger change of system for the Dutch economy than for many others. Given that magnitude it requires a coordinating and leading role of the government. Amongst the methods available to the government, integral and flexible financing capabilities are essential. Such capabilities should be able to facilitate a broad range of initiatives ranging for example from scale-ups to large scale infrastructure projects. These challenges have also been recognised at the European level and are, in part, addressed through the creation of the European Fund for Strategic Investments (EFSI).

[9] Headline Energy Data, International Energy Agency, 2014

[10] "8 miljard voor stimulering duurzame energieproductie in 2016", RVO, December 2015

[11] Motie Samson, Van Haersma Buma en Pechtold over oprichting van een Nederlandse innovatiebank om grootschalig in de ontwikkeling van duurzame energie te investeren, 17 september 2015

[12] Beantwoording vragen over de hoge kosten van wind op zee, 2013

[13] Nationale Energieverkenning, 2015

[14] Netbeheer Nederland, Net voor de toekomst een verkenning, February 2011

[15] Verkennend onderzoek warmterotonde, Cluster West 2015

Developing a balanced set of instruments and products on the national level is, therefore, crucial to address these challenges. By directly financing energy projects, NFEO would make a valuable contribution to a sector where the government's role is now restricted primarily to subsidizing both consumers and producers. NFEO would help overcome this market failure by directly (co)financing projects, offering guarantees, providing advisory services to projects and local authorities, and by functioning as a primary channel for European funds for energy sustainability – complementing existing government subsidy instruments and private sector initiatives. As a bank, it would have the possibility to offer structured solutions with different risk tranches, as required; including equity stakes and mezzanine products. It would structure Public-Private-Partnership (PPP) projects in a way that enabled private sector involvement and align the incentives of the private sector with the social goal of transitioning to a green or sustainable economy.

3. International investments and exports

The Dutch government seeks to promote international investments and exports. This includes the trade activities of Dutch companies as well as foreign aid to support economic development. SMEs often face difficulties financing their international trade activities because structuring costs can be high in relation to the small deal sizes involved. Private investors can also be reluctant to invest in developing countries given the economic and political uncertainty they often present.

These activities are currently conducted through FMO and a number of government schemes from the Ministry of Foreign Affairs, partly through RVO. However, there are still indications that market failure in this area persists[16] and it is widely recognised that improved coordination between existing international and national promotional activities would increase clout.[17] A recent report published by the Rebel Group argues that more can be achieved with the same budget in terms of development impact by realizing synergies between trade and foreign aid. For example, as the new development goals offer opportunities for Dutch companies to export their products and services, more comprehensive financing solutions and a mix of capabilities available within RVO, the Foreign Affairs Ministry and several governmental schemes will be needed.[18]

> *"A very active, competent and broad spectrum promotional bank financing international business, such as Japan's JBIC and JICA, would be a critical tool for the future development of the Netherlands' international economic activities."*
>
> Robert Poelhekke, Director, NABU

NFEO would provide the platform to facilitate this coordination, more easily combining loans to international public sector borrowers, and trade finance and investment products to Dutch SMEs. It could help Dutch companies to offer packaged solutions in developing countries – in line with existing aid and trade goals – by providing them with the financing products they need. This coordination is especially important in the Netherlands, which is a foreign trade-based economy where many SMEs must look for international opportunities to achieve growth.

[16] Arguments offered are for example that at 14%, rejection rates for trade credit applications in The Netherlands were among the highest in the Eurozone area, in line with Greece (16%) and Belgium (14%). The Eurozone average is 4%.

[17] 73% of stakeholders we discussed this topic with agreed that coordination in this area could be improved.

[18] "Trademark finance; Kansen voor Hulp en Handel", Rebel Group International, March 2015.

Because NFEO aims only to correct market failures, it would play a role that is *complementary* to the private sector. This means that it would generally be aiming to be a second-level institution – that is, one that rarely lends or invests directly with the final customer, but instead finances intermediaries that finance the end-customer. In the case of equity, NFEO can act, like UK's Big Society Capital and Business Growth Fund, as a co-investor alongside local VC funds, or as an investor in funds (that is, as a fund of funds). In this way, NFEO would make use of the strengths of private sector firms, such as their distribution networks and credit expertise. This complementary role is in line with international best practice and the European Commission's recommendations for National Development Banks.[19]

Some multinational development banks, including the European Investment Bank (EIB), the European Investment Fund (EIF) and the newly created European Fund for Strategic Investments (EFSI), offer co-investment programs that NPBIs should make use of. These sources of development funding are now under-utilised in the Netherlands. Between 2011 and 2015, the EIB invested about € 7.7 BN in the Netherlands, or 1.4% of the average GDP of that time period. This is a full percentage point below the average of 2.4% across other European countries. The Netherlands is also less effective in mobilizing EFSI funds.[20] By creating a single point of contact, NFEO ought to improve the Netherlands performance in accessing these European funds.

[19] "Working together for jobs and growth: The role of National Promotional Bank/ Institution (NPBIs) in supporting the Investment Plan for Europe", European Commission, July 2015

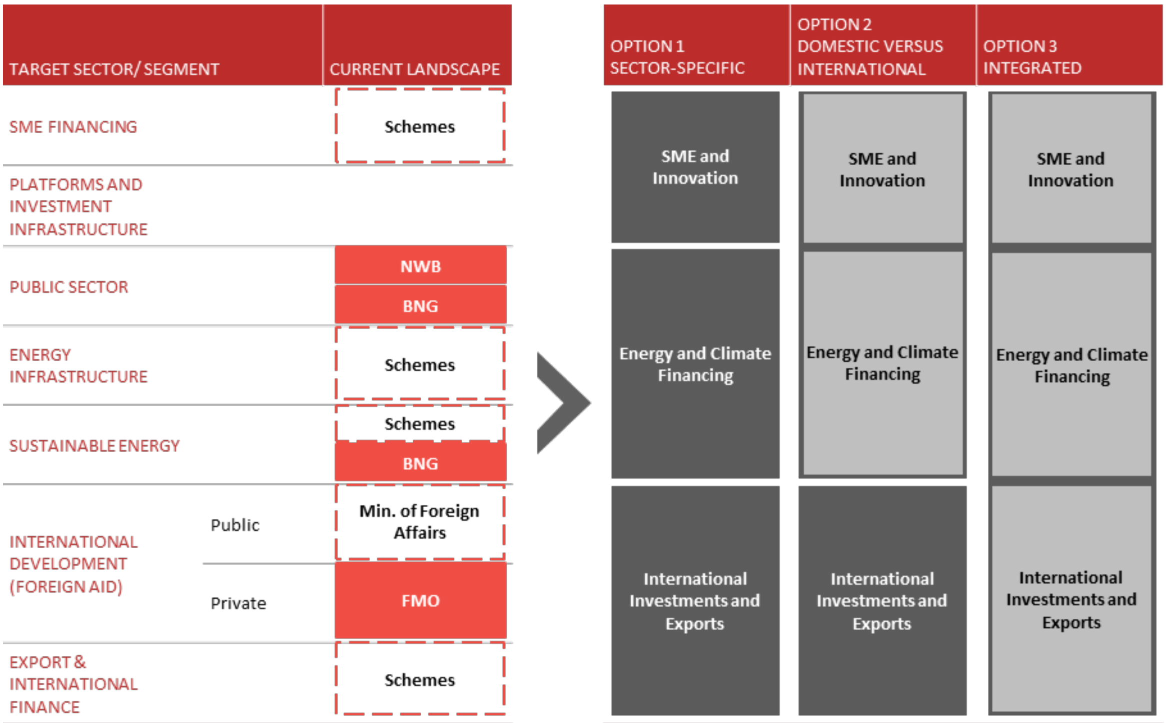
[20] "EFSI – Investment Plan for Europe: boosting jobs and growth", European Investment Fund (http://www.eif.org/what_we_do/efsi/index.htm); Data from "Finance contracts signed – European Union", European Investment Bank (http://www.eib.org/projects/loans/regions/european-union/index.htm)

2. INSTITUTIONAL MODEL

Based on models found internationally, we have evaluated three broad alternative institutional structures for NFEO (see Figure 1):

1. A **sector-specific** model, exemplified in the UK, in which separate entities, such as the British Business Bank (BBB), serve targeted sectors.
2. A **domestic-vs-international** model, as exemplified in France and Italy where the international activities are fulfilled by separate subsidiaries operating at arm's length from the rest of the group.
3. The **integrated** model, in which all sectors are served by a single group, as in Germany and Spain.

FIGURE 1: POTENTIAL INSTITUTIONAL MODELS[21]



The **sector-specific** model would improve on the current situation in terms of coordinating efforts within sectors and bringing together (sector-specific) expertise. However, it fails to address important inefficiencies and introduces complications:

- The approach would require new capital injections to establish the new entities required, such as a separate "SME bank", which does not exist today.
- The benefits of scale will not be fully achieved, resulting in higher funding and operating costs.
- Optimising the allocation of financial and human resources across separate entities is more difficult than within a single entity. At any given time, the sector-specific model is likely to result in too much financing going to some sectors and too little to others.

[21] Schemes represent a number of financing schemes managed by RVO and other governmental bodies. A detailed overview of all financing schemes included in the financial analysis for businesses and for energy sustainability is provided in our accompanying report.

The **domestic-vs-international** model faces similar issues to the sector-specific model, though synergies can be achieved with the domestic energy and SME arms under one roof. However, most of the balance sheet-related benefits of full integration would not be achieved. FMO's capital would remain trapped within the international institution, and the cost of funding would remain higher than on the integrated model on account of lower liquidity, especially for the international arm. And, again, coordination issues would persist, especially in areas where the distinction between international and domestic business is unclear, as with some energy projects and SME export finance.

"NFEO should offer co-financed solutions that allow crowding in as much investments from the private sector as possible"

Jan Dexel,
NIA

The **integrated** model appears best suited to the Dutch context. Structured as a federated model, maintaining versatility for the three component arms – and ensuring adequate cooperation while avoiding unnecessary bureaucracy, it would require no additional capital from the government. In fact, it could reduce capital costs by diversifying exposures. The increased scale in operations and liquidity of the entity's debt would reduce both (unit) operational and funding costs (refer to section 4). In addition, coordination problems that now lead to gaps, overlaps and misallocated capital would be more easily overcome by the unification of strategy, operations and information management. As such, this model would be a logical ambition for the Dutch government to aspire to.

3. GOVERNANCE

In terms of legal structure and governance NFEO should strike the right balance between, on the one hand, a professional financial institution operating at arm's length of the government, in order to avoid being considered a captive government entity for EMU consolidation purposes, and, on the other hand, sufficient influence of the government on NFEO's policy, in order to ensure that NFEO executes its public policy mandate. This requires that:

- Professional governance is fully aligned to existing international best practice for banks and NPBIs, which should facilitate an efficient and effective organisation, clear delineation of responsibilities and avoid bureaucratic pitfalls.
- The governance ensures NFEO withdraws from an activity if a market failure does no longer exist in that area.
- There is adequate government accountability and direction, but day-to-day steering and execution is at arm’s length of the government in compliance with state aid restrictions and EMU consolidation.
- There is external transparency of NFEO’s portfolio, activities, decisions and financials.

> *"Best-in-class governance is essential for ruthlessly exclusive focus on market failures and to avoid that this becomes a huge politicized government bureaucracy”*
>
> Sweder van Wijnbergen, Professor, UvA

We have looked at international best practices of NPBIs and customised them for the Dutch Context.

LEGAL FORM

It is proposed to bring the existing entities BNG, NWB and FMO and the government schemes under one roof, and to structure the holding entity of the group (NFEO) in the legal form of a Dutch public limited liability company, an N.V. (*Naamloze Vennootschap*). The N.V. is a common and easy to use legal form in the Netherlands and comes with tried and tested corporate governance rules embedded in the Dutch Civil Code. Most Dutch banks, including FMO, BNG and NWB, are organized in the form of an N.V.. This legal status provides the flexibility to adapt NFEO’s structure through transfer of shares, merger and demerger, both during its initial creation and for potential future purposes. Being an N.V. will also reinforce NFEO’s status as an organisation at arm’s length from the government and prevent it from being considered a captive financial institution for EMU purposes.

STATE GUARANTEE AND EMU DEBT

An explicit state guarantee is recommended. This would allow NFEO to borrow at a lower cost than BNG and NWB, who do currently not enjoy such a state guarantee on their liabilities. Certain other countries, such as Germany, Finland or Spain, provide an institution-wide state guarantee to their NPBIs, as the Netherlands does for FMO. Generally, guarantees for NPBIs are not recognised in state balance sheets, and the NPBI’s debt is not usually included in EMU debt.

The general principle is that guarantees of payments granted by third parties are considered contingent assets or liabilities.[22] The European System of Accounts (ESA) states that, "as they do not give rise to unconditional obligations, contingent assets and liabilities are not financial assets and liabilities".[23] A prerequisite for treatment as a contingent liability, however, is that lending decisions are taken at arm's length of the government. In addition, the governance and operations of the NPBI must be structured in a manner that is sufficiently independent from the government; otherwise, the NPBI becomes a captive financial institution whose debt is considered government debt.

OWNERSHIP

The two main questions that need to be addressed in terms of ownership of NFEO are (i) whether NFEO should be fully publicly owned or may also have private shareholders and (ii) whether the Dutch State should hold 100% of the shares or merely a majority. Ownership models with full public ownership and with public as well as private shareholders would both be viable, although the former is standard among peers. As to the shareholding of the Dutch State, it is recommended that it owns at least a majority of the shares.

> *"In some cases we need to get the government to participate in investment funds that we are setting up because this role of risk bearing co-investor or guarantor is necessary to get private parties in. In these cases the government ought to act quickly"*
>
> Loek Sibbing, CEO, NII

Given NFEO's mandate, which is to focus on market failures and not on commercial activities, full public ownership would be logical. This would allow application of the mitigated large companies regime (*verlicht structuurregime*), which allows shareholder appointment of members of the Management and Supervisory Boards. In case NFEO is partly owned by the Dutch State and partly owned by other public bodies, the mitigated large companies regime can be applied after all shareholders have entered into a mutual cooperation arrangement (*onderlinge regeling tot samenwerking*) such as a shareholder agreement. However, full public ownership may be more difficult to achieve as the private parties that are currently shareholders in FMO must be bought out and compensated.

A mixed public and private ownership model would be a viable alternative, where private shareholders could be seen as disciplining NFEO to stay focused on its mandate of addressing only market failures. A mixed public and private ownership model would also be the easiest to achieve, being the default outcome of the contribution of shares in FMO, BNG and NWB into NFEO in exchange for shares in NFEO.

Irrespective of the participation of private shareholders, a model in which the Dutch State is a majority shareholder in NFEO is recommended as, in line with its risk measures assessment policy (*toetsingskader risicoregelingen rijksoverheid*), the Dutch State is expected to want sufficient means to influence the risk it will be exposed to if it is to provide a guarantee to NFEO.

[22] Article VII.4 of "Manual of Government Deficit and Debt – Implementation of ESA 2010", Eurostat, 2016

[23] ESA 2010 5.08

BOARD STRUCTURE AND COMPOSITION

The large company regime (*structuurregime*) and banking regulations will oblige NFEO to adopt a two-tier board structure for NFEO, with a Management Board and Supervisory Board.

During the transition of the different entities towards the NFEO end state, the decision making bodies of the entities could be aligned as far as possible. This can be facilitated by appointing some of the supervisory board members of FMO, NWB and BNG to the boards of NFEO. As soon as FMO, BNG and NWB are subsidiaries of NFEO, all Management and Supervisory Board positions within the NFEO group will count as one directorship.

The members of the Supervisory Board at NFEO and its subsidiaries must function independently. However, it is allowed that a minority (less than 50%) of the members are not formally independent and may thus have a connection with a specific stakeholder. The Supervisory Board will have committees on remuneration, audit, risk/compliance and nomination, in line with rules applicable to banks, such as CRD IV and the EBA guidelines on internal governance.

It is desirable to install advisory committees to represent the interests of relevant stakeholders, such as government ministries, local governments and civil society, and to bring technical expertise to NFEO. These advisory committees should be structured in such a way that the influence of the NFEO stakeholders is embedded strongly enough in the organisation to actually matter, while the organisation retains sufficient independence and flexibility. The advisory committees may have an influence on policy but not on day-to-day decisions of NFEO and its subsidiaries, in line with the requirement that NFEO should not be a captive of the government.

We recommend a mandatory external review, in line with international best practices for development finance institutions. An independent body should regularly (e.g. semi-annually) assess NFEO's mandate and activities against economic developments and market failures. In addition, NFEO will adopt established practices among other NPBI to provide ex-ante and ex-post evidence of mitigating market failures.

CAPABILITIES

NFEO should be a promotional financial institution, not a government department. Hence it should establish best-in-class risk management practices, in line with the latest Basel regime and relevant regulations and guidelines, including the EBA guidelines on the Supervisory Review and Evaluation Process (SREP) on internal governance. As NFEO would in many cases provide first loss financing tranches, NFEO's exposure to risks and adverse selection is disproportionately high compared to the private sector. Combined with its size, NFEO's ambition should be to significantly improve today's standards and become a market leader for risk management in the Netherlands. This will require bringing in significant additional expertise from the private sector.

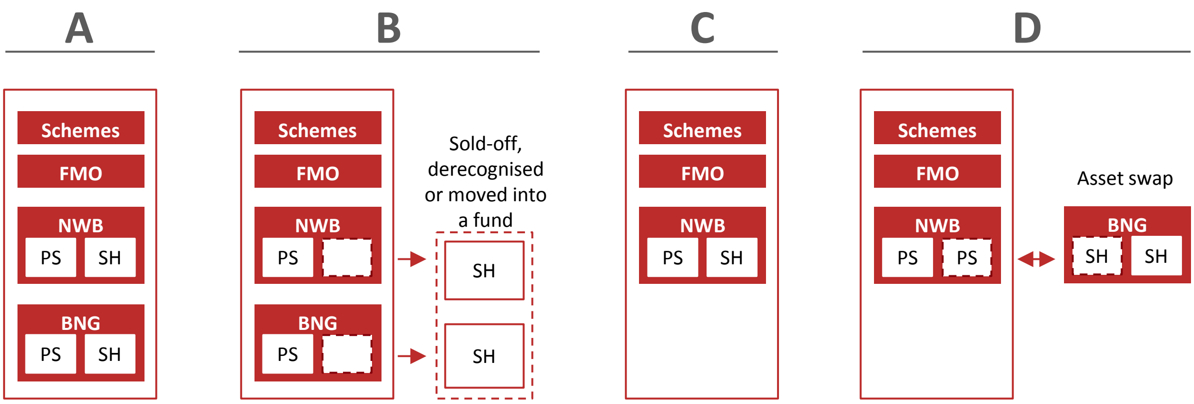
In terms of human resources, the increased size of the organisation would support better brand positioning and wider career opportunities to retain current and attract new employees and would make it easier to attract further financial expertise in the areas where NFEO will be active. Other capabilities and shared services are likely to benefit from scale as well. For IT, a consolidation of systems and data management capabilities would lead to higher transparency and enable better decision-making. Similarly, the audit function's capabilities can be substantially enhanced through scale. This will also be an important mechanism to ensure proper governance and discipline throughout the organisation.

4. ALTERNATIVE PORTFOLIO STRUCTURES AND FINANCIALS

4.1. ALTERNATIVE PORTFOLIO STRUCTURES

We have identified four portfolio structures within the integrated model. In each structure, NFEO would consist of the three "arms" described in section 1: SME and innovation, Energy and Climate Financing and International Investments and Exports. Figure 2 shows four ways this could be achieved.[24]

FIGURE 2: ALTERNATIVE PORTFOLIO STRUCTURES FOR NFEO



PS = public sector, SH = social housing

The assets of BNG and NWB currently include €86 BN of social housing loans: 56% of their combined loan portfolios and 36% of their combined assets. The role of social housing corporations in providing affordable housing is undeniably socially useful. However, because of a lack in compatibility with the three core arms, and to maintain a size in line with international NPBIs, we argue to separate social housing loans. Loans to social housing corporations could be made by commercial financial institutions. In fact, some already are and sometimes at rates lower than those charged by BNG and NWB. If the housing portfolios are bundled in a separate entity it would – with the right structure and governance –be easier for institutional investors to step in.

"Less fragmentation of the different schemes aimed at investing in SMEs will improve efficiency. Advanced coordination at the national level will provide regional development organisations with better and more efficient access to extra seed and start funds, including funds from the EU, to be able to scale-up regional blue chips into international winners"

Marius Prins,
PPM Oost

The implications of each of the four portfolio structures are summarised in the table below.

[24] In making the following financial estimates, high-level assumptions about existing government schemes were required given the lack of publicly available information. Derivative positions were associated with the loan portfolio (incl. social housing loans) on a pro-rata basis.

TABLE 1: IMPLICATIONS AND CONSIDERATIONS FOR NFEO PORTFOLIO STRUCTURES

	A	B	C	D
DESCRIPTION	Combined entity of BNG, NWB, FMO and schemes	Combined entity of BNG, NWB, FMO and schemes excluding social housing	Combined entity of NWB, FMO and schemes	Combined entity of NWB, FMO and schemes, including BNG public sector and excluding social housing
GOVERNMENT SCHEMES	• Transferred to NFEO if possible • Others (e.g. guarantees) may remain (temporarily) on the Government's balance sheet but would be managed by NFEO			
ORGANISATION	• Resources and systems drawn from BNG, NWB, FMO and RVO		• Resources and systems drawn from NWB, FMO and RVO	
BALANCE SHEET COMPOSITION	• Assets from BNG, NWB, FMO and schemes	• Assets from BNG, NWB, FMO and schemes • Excluding social housing loans	• Assets from NWB, FMO and schemes	• Assets from NWB, FMO and schemes • NWB's social housing loans sold to BNG • BNG's public sector loans acquired by NFEO
FINANCING OF SOCIAL HOUSING LOANS	• No change	• Loans are moved into an SPV/fund or sold to investors • >95% of the risk is sold to investors and loans are derecognized	• No change	• BNG becomes the main financing company for social housing corporations
MANAGEMENT OF SOCIAL HOUSING LOANS	• No change	• NFEO could manage social housing loans if required	• No change	• BNG manages social housing loans

In portfolio structures B and D social housing loans are excluded from NFEO. Portfolio structure B provides more scale than D due to the inclusion of assets, resources and systems from BNG. This structure would also simplify the Dutch promotional landscape. Therefore, we have focused below on the financial indicators and synergy benefits of portfolio structure B. Note that in portfolio structure B the social housing portfolio is sold-off over time and this option does not require equity to be transferred. More thorough analysis of the other portfolio structures is included in the full report.

Financing of Public sector, energy and climate investments would represent 80% of NFEO's assets. This arm will be built from BNG's and NWB's current expertise and assets, which consist primarily of loans to public sector institutions (about €60 BN, primarily to municipalities, water boards and healthcare).

The international arm of NFEO would account for most of the rest of its assets, building on FMO's €8 BN of debt and equity. Some export financing schemes could be transferred from RVO. Additional export and project finance products, such as export refinancing facilities, may need to be developed. If public-to-public development operations were included (as with Germany's KfW Development Bank and France's AFD), NFEO may also need to bring some assets from such current government schemes onto its balance sheet.

> *"We observe that National Promotional Institutions generally provide valuable advisory services to SMEs and they therefore constitute key partners for the European Investment Advisory Hub; in the Netherlands, where no such NPI exists, smaller companies need to go looking for support and advisory services more and so it's harder for the Hub to find the right local partner in this context"*
>
> Simon Barnes, Director, EIB

Some existing SME financing assets, which are largely guarantees, can be transferred from RVO. However, the sums involved are relatively small. New products will need to be created and new assets acquired, which can be managed with existing balance sheet capacity (i.e. capital).

4.2. FINANCIALS

Merging the three existing institutions and schemes would generate substantial financial benefits. We expect three areas of savings (see Table 2).

TABLE 2: COST SAVINGS

AREA OF SAVING	SOURCE OF SAVING
1 FUNDING COSTS	• NFEO's scale would increase the liquidity of the bonds issued and thereby reduce the cost of funding (illiquidity premium) • NFEO's liabilities would be guaranteed by the Dutch Government, generating a funding benefit of 5-20bps vs. current situation
2 CAPITAL REQUIREMENTS	• The creation of a single institution could unleash "trapped capital". Capital that is currently spread between different institutions may be greater in aggregate than the capital required for the unified entity with its diversified portfolio
3 OPERATING EXPENSES	• The inclusion of multiple institutions would reduce operating costs significantly • The total impact of these efficiency gains will depend on the scope of the selected institutional model; however, our expectation is that savings would be between 5-10% and assume 7.5% for calculation purposes

For the preferred portfolio structure B, a funding advantage of approximately €100 MN p.a. is expected in current market conditions.[25] Operating expenses could be reduced by €20 MN p.a. Also, due to complementary balance sheets in terms of capital and liquidity constraints, an estimated €2 BN of capital is freed up immediately on combination. To get to a leverage ratio of 3% BNG and NWB have been forced to commit to retain €1.2 BN over the coming years. If the entities are brought together, the combined balance sheet would have a leverage ratio of 3.4% and a CET1 ratio of 26%. The current need for introducing additional capital would be eliminated (hence a €1.2 BN advantage over the current situation). In fact, the combined balance sheet would immediately free up €850 MN of capital above reasonable minimum constraints of a 20% CET1 and a 3% leverage ratio, creating the total €2 BN immediate advantage. This capital can now be used flexibly to serve the mandate of the new institution, within appetite limits for each of the three arms.

TABLE 3: INDICATIVE FINANCIAL AND OPERATIONAL BENEFITS BASED ON 2015 INSTITUTIONS RESULTS

CATEGORY	CURRENT EXPENSES	SYNERGIES	BENEFITS OF PORTFOLIO STRUCTURE B
FUNDING COSTS SAVINGS (€ MN P.A.)	2,173	-10bps funding costs	97
OPERATING COST SAVINGS (€ MN P.A.)	209	7.5% reduction	16
CAPITAL SAVINGS (€ BN ONE-OFF)	-	Leverage ratio >3%	2[26]

The funding and operational cost savings of approximately €120 MN in total could be used to increase NFEO's equity capital and hence its lending capacity, to lower the interest rates it charges to borrowers or to improve its operations, for example, in risk management and financial expertise. We estimate a return on equity (RoE) range of 4.4% to 7.9%, depending on if freed up capital from housing activities is used for strengthening its balance sheet or deployed as additional lending. This would be in line with peer European NPBIs and would ensure the financial sustainability of NFEO's promotional activities over time.

[25] Note that if markets revert to higher interest rates, the funding advantages should be significantly higher.

[26] Both BNG and NWB currently have a leverage ratio below the minimum Basel III threshold of 3% (2.6% and 2.1% respectively). A capital increase of €1.2 BN would be required to increase the leverage ratio of both entities to 3%. In case of a combined balance sheet, both would benefit from FMO's excess capital and no capital injection would be required.

Average RoEs from 2010-2015 for major European NPBIs range from 1.3% to 10.6%, with a group average of 6.0%.[27]

TABLE 4: KEY FINANCIAL FIGURES FOR EXISTING INSTITUTIONS (2015) AND PRO-FORMA FOR NFEO PREFERRED PORTFOLIO STRUCTURE (INCL. SYNERGIES)

RATIO	CURRENT SITUATION				PORTFOLIO STRUCTURE B
	NWB	BNG	FMO	SCHEMES	
BALANCE SHEET SIZE (€ BN)	91	150	8	0.5	144
CORE TIER 1 CAPITAL	1.3	3.0	2.3	-	6.6
CORE TIER 1 RATIO	65%	23%	23%	–	26%
LEVERAGE RATIO	2.1%	2.6%	22.6%	–	5.8%
NET PROFIT (€ MN)	95	226	174	0	403
COST : INCOME RATIO	22.8%[28]	22.6%[28]	25.0%	-	26%
RETURN ON EQUITY	6.8%[28]	7.6%	7.5%	–	4.4%-7.9%[29]
RETURN ON ASSETS	0.1%[28]	0.2%28	2.1%[28]	–	0.3%

If on top of the €2 BN freed up capital mentioned above, the funding cost savings can be retained over the next 5 years, this would add approximately €0.5 BN to free capital. Under structure B, social housing assets would be placed outside NFEO and possibly sold over time to private investors (though they could still be serviced by NFEO), releasing another €0.7BN of capital once completed. These amounts can also be used to strengthen NFEO's balance sheet further or, again, used to extend promotional activities significantly.

In total, this would amount to about €3.2 BN of additional capital either freed up or built up over time in this structure. The exact amount of additional lending possible is dependent on the risk associated with that lending. If we put in place conservative constraints on the lending activities of our proposed structure, with a leverage ratio of at least 3%,a minimum Core Tier 1 ratio of 20% and assuming an RWA density for new lending of 66%, the newly combined entity will have more than €24 BN of lending capacity according to our estimations[30]. Looking at the market as a whole, the impact of this amount of additional lending can be multiplied by drawing in additional private sector lending on top of NFEO transactions (crowding in private sector participants), by stronger partnership with the EIB and possibly by transferring a small proportion of energy subsidies to energy financing through NFEO. All in all, we feel comfortable that more than € 100 BN of additional lending capacity can be generated through these combined levers – e.g. in line with the total need estimated recently by VNO-NCW.[31]

[27] Analysis includes RoEs of KfW, CDP, Finnvera, EIB, CDC, Bpifrance and ICO from 2010-2015. Refer to our accompanying report for further details.

[28] Calculated values based on annual reports and Oliver Wyman analysis

[29] 4.4% if assumed that all capital released from separated housing activities is held to strengthen the balance sheet and 7.9% if all this capital is deployed for promotional lending. In reality, it is likely that the bank will make a trade-off which results in an RoE somewhere in this range.

[30] As conservative constraints assuming a 20% CET1 ratio, a 3% leverage ratio and that (new) NFEO loans can - on average - be represented by a 66% risk weighting.

[31] VNO-NCW, MKB Nederland, and LTO Nederland. Brochure – NL Next Level. The Hague: VNO-NCW, MKB Nederland, and LTO Nederland, 16 June 2016. Web. Accessed June 2016.

5. PRUDENTIAL SUPERVISION

We see various approaches to the supervision of NPBIs, which range from self-supervision to supervision by the same authority that supervises commercial banks. Similarly, the regulations controlling an NPBI's prudential and conduct requirements can be specific to the institution or the same as those governing commercial banks.

In line with commercial banks, most NPBIs and the European Commission's vision for NPBIs, we recommend NFEO be supervised by an independent external supervisor to ensure strong risk management and enhance external credibility. Providing too much flexibility to NFEO may lead to a lack of accountability for the management. A pre-defined framework in which it operates to prevent management from over-reaching its capabilities is essential.

"Our charitable foundation set €15 MN aside to build a fund for e-health scale-ups that is open for other investors. However we found that without tailored government involvement, private parties are not willing to join us. So for the moment, we'll stick to direct investment on our own"

Paul Baan,
Noaber

In the model with NFEO as a holding company and FMO, NWB and BNG as subsidiaries, the NFEO group will constitute a significant banking group. Based on current law, each of FMO, NWB and BNG will automatically be subject to direct supervision by the ECB, as will the group as a whole on a consolidated basis.

We recommend that the NFEO group ultimately be subject to a national tailor-made supervision regime. This has the added benefit that the normal regulatory requirements designed for commercial banks can be adjusted to reflect the risks that a NPBI is exposed to (e.g. in terms of capital and liquidity requirements, and recovery and resolution planning). Additionally, a national supervisory regime would conform with NFEO's scope as a Dutch promotional bank, tailored to the local market and activity. It would be consistent with most other NPBIs (e.g. KfW, ICO, CDP). If a tailor-made supervisory regime is adopted, we propose appointing DNB as the main supervisor, given the purpose and importance of NFEO.

A national tailor-made supervision regime has to be set up in co-operation with DNB, ECB and the European Commission, because it requires an exemption from CRD IV. Many NPBIs benefit from this exemption, and the European Commission is expected to grant requests for new NPBI exemptions of CRD IV if they do not differ from previously granted exemptions. Of course, NFEO should already be viable under CRD IV, hence a special regime would not be a precondition for it to start operating.

6. IMPLEMENTATION AND TIMELINE

The creation of NFEO as a core institution could already be in place and operational after 4-6 months, with another 14-18 months to fully convert to the target operating model. The current activities of BNG, NWB, FMO and selected schemes would not be interrupted during the implementation of NFEO. Once political support has been obtained, several workstreams could start in parallel, establishing NFEO's governance structure, operations and legal framework. There are three major steps that the implementation phase would comprise:

- Step 1: Setting up the core.
- Step 2: Bringing current activities under one roof.
- Step 3: Implementing target operating model.

"SMEs have more trouble getting financing than they should, as processes are complex and take time and resources to complete.

"A professional promotional bank partly aimed at SME would help streamline the process and would likely draw in more private (co-) investment as well."

Jan de Ruiter,
Advisor and former CEO, RBS

6.1. IMPLEMENTATION THEMES AND KEY ACTIVITIES

As shown in Figure 3 below, we see three broad themes with several activities underneath that need to be addressed for creating NFEO.

FIGURE 3: IMPLEMENTATION THEMES AND KEY ACTIVITIES

IMPLEMENTATION THEMES	KEY ACTIVITIES
A Governance	A1: Governance and ownership model A2: Detailed Governance structure
B Operations	B1: Portfolio structure, mandate and target activities B2a: Target operating model blueprint and processes B2b: HR and change management B3: Detailed blueprint and implementation
C Legal	C1: Incorporation NFEO (Initial legal structure and approvals) C2a: Transfer of shares and schemes C2b: Regulatory aprovals transfer of shares C2c: State aid approval C3a: Integration C3b: Regulatory approvals integration C3c: Establishing a tailor-made supervisory regime

The **Governance activities** outlined under theme A mainly comprise the definition of NFEO's core governance structure and ownership model. During the first step, NFEO's shareholder structure would have to be defined and approved as well as the structure, composition, role and responsibilities of NFEO's

Management and Supervisory Board as well as additional Committees to be agreed. In a second step, further governance requirements need to be assessed, defined and implemented, including for example the delegation of authorities and credit approval processes or the design of the Management Board and Advisory Committee landscape.

The activities in theme B centre around the **operational setup** of NFEO and should essentially ensure an efficient and effective target institution. In a first step, the mandate of the organisation, targeted market failures and business activities of NFEO need to be specified, as well as the overarching portfolio structure of NFEO (of which entities it should comprise). In a second and third step, a more detailed target operating model will have to be developed, including for example its product and distribution strategy, the setup of key functions such as risk management, finance, IT, HR and audit and their corresponding strategies. Finally, the previously developed blueprint will have to be implemented and put into practice.

"There are not enough platforms for large institutional investors to finance SMEs, e.g. via an investment in a vertical slice (e.g. securitization) or identifying high potential start-ups. In a small market like the Netherlands, this is a market failure that may need to be addressed by government intervention, esp. through a national promotional bank."

Leen Meijaard,
Blackrock

Finally, a number of **legal implementation** actions are required in the setting up of NFEO, depending on the end-state model. Without being exhaustive[32] the key actions which will have to be performed are the following. The first step comprises the incorporation of NFEO, mainly the setup of its initial legal structure and receipt of government and parliamentary approvals. This for example includes government approval and parliamentary no objection to incorporation of a private law entity as well as to a state guarantee. During the second step, shares of the current entities would have to be transferred to the new entity. For this, regulatory approvals have to be obtained. The acquisition by the new NFEO entity of all shares of FMO, NWB and BNG constitutes the acquisition of a qualifying holding in a bank and as such requires a declaration of no objection (DNO) from the ECB prior to the transfer. Similarly, the (indirect) acquisition by NFEO of all shares in FMO's investment management subsidiary constitutes the acquisition of a qualifying holding in an investment firm which requires a DNO from DNB prior to the transfer. In addition, State aid approval is required. The establishment of NFEO should not proceed without a formal or at least informal assessment and approval by the European Commission. During the final third step, the full integration, including potential legal merger of subsidiaries, occurs. This also requires respective regulatory approvals. A legal merger or a substantial restructuring or asset liability transfer of FMO, NWB and/or BNG also requires a DNO from DNB. Past experience has shown that the ECB is closely involved in such procedure. Lastly, a tailor-made supervisory regime could be considered for NFEO. The implementation of a tailor-made regulatory regime for NFEO requires an exemption from the normal rules of banking regulation of CRD IV. A request to that effect may be made to the European Commission.

6.2. INDICATIVE TIMELINE

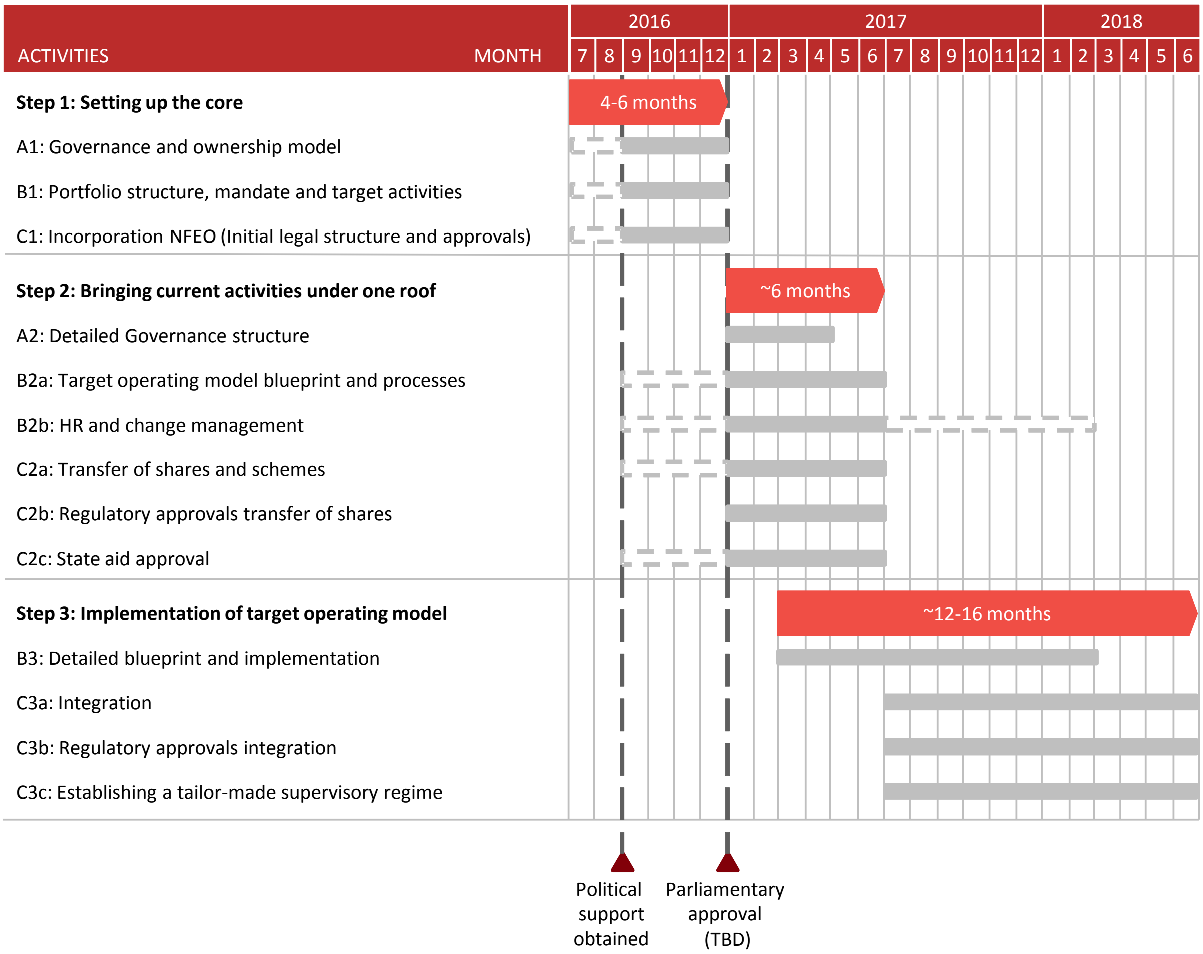
The core structure of NFEO could be established within 4-6 months. This would include obtaining the required government and parliamentary approvals, setting up the governance and ownership model of the NFEO group, defining its portfolio structure, mandate and target activities and incorporating NFEO.

[32] Not all required actions are included in this chapter (e.g. works council requirements, staffing of mandatory committees etc.).

The second step comprises of bringing FMO, BNG, NWB and selected schemes under one roof, the detailing of NFEO's governance structure, the blueprinting of NFEO's target operating model and some initial quick fixes. This could be achieved approximately 6 months after completion of the first step.

Finally, the third implementation step would be dedicated to further detailing of the target operating model blueprint and its implementation as well as the further integration of the business of FMO, BNG, NWB and the relevant promotional schemes. This could be finalized within approximately 8-12 months after completion of the second step. A potential fourth step could follow after this, which should consider a further streamlining of NFEO's activities as many policies and procedures from the existing entities will likely only add on to another during the first three steps. To ensure highest operational efficiency and effectiveness, all of these should eventually be adapted and merged into a coherent strategy and approach. For example, this could involve building one common IT platform. Figure 4 below summarizes the required activities and timelines.

FIGURE 4: INDICATIVE TIMELINE FOR CREATING NFEO



FREQUENTLY ASKED QUESTIONS

1. Why do we need another state-owned entity and wouldn't it become ungovernable due to its size?

The creation of government entities often leads to a loss in dynamism and increase in bureaucracy. However, this can be avoided through several mechanisms. First, we suggest establishing three arms as coherent units that can be effective in their field and reap synergies under one roof. Second, strong governance needs to be put in place that ensures coordination and a clear delineation of responsibilities between the arms, regular reviews of the institution's adherence to its mandate and sufficient transparency on the institution's activities - as outlined in this policy brief. Broad spectrum national promotional banks exist in most European peer countries, whereas its absence in the Netherlands inhibits sufficient promotional activity where it matters.

2. Why should the institution be guaranteed by the state?

- The existing promotional landscape is to a large extent already backed by the state, both implicitly and explicitly. FMO has a direct government guarantee and, arguably, recent history has shown that the state would recover losses in case of a crisis situation at BNG and NWB; i.e. an implicit guarantee. An explicit guarantee would bring with it the opportunity for the state to cover the risks which are de facto already present by ensuring strong governance, an explicit mandate and best practice risk management. Moreover, most of the BNG and NWB assets are already state-guaranteed.
- For the preferred option in this report, in which the social housing portfolio is separated from the entity and private investment is attracted, a guarantee is no longer needed for this portfolio. Hence the combined total of implicit and explicit guarantees would be lower than in the current situation.
- At the same time, a state guarantee to promotional banks is also seen in international practice, e.g. KfW, ICO, Finnvera all have explicit state guarantees.
- In current market conditions, we expect the funding advantage to be €100 MN per annum. Without a guarantee, the state would not reap these financial benefits fully. In potentially higher interest rate environments in the future, this benefit could be substantially higher.
- We recognise that the government requires fair compensation for extending new guarantees. Although for an entity owned by the state this is a technicality (RoE would be reduced by the same amount), a fair compensation is likely to be in the order of magnitude of a few bps.
- Even without providing an institution-wide guarantee, the argumentation for benefits of creating NFEO would outweigh any potential drawbacks.

3. How can it be ensured that NFEO operates only within its mandate and does not do business the private sector is better placed for?

NFEO's operations need to be guided by a clear mandate. In addition, strong and disciplined governance is essential to ensure that NFEO's activities remain in line with its mandate. An internal Evaluation Office should be put in place that regularly reviews any changes in the market landscape and whether NFEO's activities are still limited to address market failures. These internal evaluations would be complemented by periodic reviews by external independent parties. The results of these reviews as well as NFEO's business performance in general should be published in order to ensure maximum transparency to the public. In our opinion, the current environment in the Netherlands allows for only limited control over the mandate and activities performed by the Dutch promotional institutions. This is one of the key concerns that could be mitigated by the creation of NFEO.

4. What is wrong with the status quo and why should it change now?

- The current promotional banking landscape in the Netherlands is highly fragmented, with a number of institutions (BNG, NWB, FMO) and national as well as regional governmental schemes (managed by RVO and others) independently providing support to the Dutch economy. This fragmentation makes it difficult to coordinate activities between the entities, offer expertise and improve access to financing and capital to those sectors in the Netherlands which have a need for it.
- Moreover, fragmentation is creating operational and funding inefficiencies. Especially at a time when the European Commission is encouraging all countries without an NPBI to establish one and when European funds such as the Juncker plan should be leveraged to support national efforts, a central point of contact in the Netherlands is urgently needed.
- Finally, the current setup has important gaps such as for energy and climate sustainability financing where the Netherlands has fallen behind internationally.

5. What would the establishment of NFEO mean for local governments and the ROMs?

The Regionale Ontwikkelings Maatschappijen (ROMs) provide valuable roots into the regional and local economy. Establishing NFEO would support their work by offering a strong national partner with financial expertise, financial scale and access to EU funds. In addition to supporting the ROMs, NFEO could offer financing to local authorities at better rates than currently available from BNG/NWB.

6. Would NFEO lead to an increase of state debt?

We think it is possible to structure NFEO without any implications for the Netherlands' EMU debt levels. This is also what we have observed for other European NPBIs. A key prerequisite will be for NFEO to operate at arm's length to the government, which would be preferable also from a governance perspective. A more detailed assessment has to be undertaken and NFEO's target operating model and legal structure designed accordingly.

7. What is the purpose of NFEO?

NFEO should dynamically identify market failures, mitigate these by developing effective solutions, resolve market failures when possible over time, monitor its alignment of activities with changes in the market environment and exit from activities if market failures cease to exist. Initially, we recommend NFEO to focus on areas that have already been identified as market failures and which are addressed by existing promotional institutions in the Netherlands.

8. Why are you recommending an integrated model?

An integrated model is not the only option for creating NFEO. It is possible to proceed with two or more institutions not combined under one roof. However, this model does not allow reaping the full benefits in terms of a coherent strategic focus, better coordinated activities, higher expertise, a better brand positioning and single face to the customer as well as large financial synergies. Most peer NPBIs chose an integrated model, which best suits the internationally open Dutch economy.

9. Aren't the existing entities good enough?

We have spoken to a large number of stakeholders and came across a variety of opinions on the required quality of operations, risk management and transparency. Regardless, we believe NFEO - as a state-backed institution - should aspire to adopt best practice standards. Especially, this applies to the application of best practice expertise and risk management standards in line with requirements for commercial banks. As size typically facilitates talent attraction, we think that as an integrated broad spectrum promotional bank it would be easier for NFEO to hire qualified and experienced staff.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

ABOUT DE BRAUW BLACKSTONE WESTBROEK

De Brauw Blackstone Westbroek is a law firm with a global reach. It has a robust corporate practice, a centre of excellence in litigation, and an unparalleled team of regulatory experts.

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