



The nationalisation of SNS – lessons learnt

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On February 1 2013 De Nederlandsche Bank (DNB) nationalised SNS Reaal Group. The Dutch central bank used powers granted to it under the local implementation of the Bank Recovery and Resolution Directive (BRRD), the Special Measures for Financial Corporations Interventions Act.

Shareholders and subordinated creditors were expropriated without compensation as a last resort to prevent systematic contagion throughout the Dutch financial sector.

Whilst the intervention act provided an important tool to prevent the collapse of SNS, some crucial aspects of the BRRD were not in place early enough to prevent the deterioration of SNS, most importantly a requirement for financial institutions to plan and prepare for scenarios that could lead to their failure, and early intervention measures allowing regulators to intervene in the management of banks.

In the light of the current regulatory framework, this article considers the background which led to the nationalisation of SNS and discusses whether the planning and preparation requirements and the early intervention measures provided under the BRRD could have resulted in a different outcome for SNS.

SNS – structure and history

SNS is a financial services provider which, before its nationalisation in 2013, comprised of SNS Bank, which was the fourth largest bank in the Netherlands, and its subsidiary Reaal, the country's second largest life insurer and fifth largest non-life insurer at the time.

SNS' problems originated from over-exposure to domestic and foreign real estate markets. A strategy of rapid expansion saw SNS acquiring a number of Dutch regional banks and insurers in the early 2000s. In addition, Bouwfonds was taken over from ABN Amro in 2006. The specialist real estate lender provided exposure to US and Spanish real estate markets.

Consequently, the ratio between SNS Bank's balance sheet total and its real estate finance practice shifted to approximately 10%, a significant size compared to other similar banks at that time. The collapse of the global real estate market resulted in significant write-downs in its real estate portfolio in 2009 through to 2010 with further write-downs in 2012 and 2013.

Reaal's main issues related to compensation claims for miss-selling investment-based insurance endowments. Between 2012 and 2014 Reaal made provision for compensation claims of E400 million (\$505 million), but it was unclear at the time whether such provision would be sufficient. The parent, SNS Reaal, raised finance which was loaned on to SNS Bank and Reaal. As the assets of both SNS Bank and Reaal devalued in the financial crisis, the risk profile of SNS increased.

Between 2009 and 2012 SNS conducted a number of buy-back transactions. This reduced the level of debt that could be 'bailed in' as well as reducing cash reserves. In 2009 SNS bought back E250 million in hybrid capital and between 2009 and 2012 it bought back or repaid almost E3 billion of debt. Between 2010 and 2012 Tier II capital with bail in potential fell by E322 million in total.

When the situation of SNS deteriorated in the light of the financial crisis, the bank required state support in 2008 and it enrolled in the credit guarantee scheme of the Netherlands, issuing approximately E5.4 billion of a E20 billion medium term note programme. In addition, the DNB



also injected E750 million in the form of hybrid capital securities. It is understood that the majority of the proceeds were utilised in the insurance arm of the business.

The central bank finally actively intervened in 2013, as the strain on SNS' balance sheet and a cash crunch left SNS and DNB with little option but nationalisation. The situation was aggravated by the impending maturity of E550 million of debt due in March 2013 and repayments due at the end of that year to DNB in relation to funds lent to assist with capital requirements.

Nationalisation of SNS

The Dutch intervention act, which sought to implement the BRRD, was enacted in 2013. Following the banking crisis across Europe, it became apparent to regulators that the majority of European jurisdictions were ill equipped to deal with failing financial institutions. The BRRD introduced a number of resolution measures which regulators could use to intervene in the conduct of failing banks.

However, the key emphasis of the BRRD is on preparation and planning measures and early intervention. It is clear that European regulators see the use of the resolution measures as a last resort, while the planning, preparation and early intervention powers are intended to avoid the need to resolve a financial institution.

The SNS case demonstrates that the key to whether the BRRD will be a success lies in the planning and preparation for a worst case scenario, and the use of early intervention measures provided to authorities.

Arguably, DNB passed on several opportunities to intervene between 2008 and 2013 in relation to SNS, which could possibly have led to a private sector solution avoiding the need to nationalise the bank.

In tandem with the BRRD's preparation and planning requirements the ongoing comprehensive assessment by the EU – an asset quality review to promote transparency and equilibrium with regard to bank exposures and a stress test of the resilience of banks' balance sheets – is expected to reduce the likelihood of similar situations arising again in the future in the European financial sector.

The BRRD requires that all banks, together with their relevant national authority, prepare a recovery plan setting out situations that may put the institution at risk and details the steps to take in such a scenario. Whilst the main emphasis of the recovery plan is to ensure the preservation of critical functions, it also aims to identify a bank's potential over-exposure to a particular sector. Furthermore, the recovery plan is intended to consider any obstacles to resolution of a bank in crisis. To remove such obstacles national regulators can require banks to carry out a corporate restructuring.

The early intervention measures, which include the removal of management, the appointment of an interim administrator and the requirement to carry out a debt and/or corporate restructuring, are designed to enable regulators to take action in the hope of preventing the need for a bailout of a bank at the taxpayers' expense.

With the benefit of hindsight, it seems that more could have been done to restructure SNS before the need for nationalisation, if the extent of the problems had been identified sooner. The acquisitions completed in the early 2000s left SNS overexposed to the property markets and the group failed to restructure or make sufficient write-downs to adequately reflect the scale of the problem.

Notwithstanding the collapse of global real estate markets and the need for state aid in 2008 and 2009, neither SNS nor DNB recognised the full extent of SNS' problems. By the time DNB took formal action in relation to the restructuring of SNS in 2012 there were limited options available given the level of uncertainty surrounding the bank's real estate portfolio.



Before the nationalisation the bank, together with DNB, considered various options available during 2012. As the Netherlands' fourth largest bank with a consolidated balance sheet total of E82 billion (as per half year 2012) SNS was identified by DNB as a 'domestically systematically important financial institution,' despite being relatively small compared to its European contemporaries. DNB was therefore motivated to avoid a failure of SNS.

In addition, SNS had approximately one million account holders with E35.5 billion of deposits, E32 billion of which were guaranteed by the Dutch deposit guarantee system. In the event of a failure of SNS, the E32 billion of guaranteed deposits would be shared amongst all other institutions participating in the guarantee scheme. Based on historic rates DNB calculated that those institutions would likely recover 85% of guaranteed deposits, resulting in an aggregate loss of E5 billion. This, DNB feared, might be sufficient to undermine the viability of those banks.

In late 2012 the Dutch finance minister sought the views of the European Commission (EC) with respect to the options available to SNS in order to ensure that any restructuring satisfied EC criteria. By November 2012 it was clear that other than an injection of capital at the expense of the taxpayer, options were limited. Allowing SNS to default on its maturing liabilities was seen by the authorities as an unattractive alternative given the systematic significance of SNS, and also in view of the loss that other banks participating in the deposit guarantee scheme would suffer.

It was considered at the time that a default by SNS may result in a run on other banks in the Netherlands. In addition, a default would have resulted in a significant loss to the Dutch government: at that time the state held core tier 1 securities with a face value of E565 million and a premium of E283 million and had exposure to state guaranteed bonds of approximately E400 million.

Other options presented to the EC included a private merger or acquisition, a private sector capital injection and capital restructuring, an asset and liability transfer and, as a last resort, nationalisation of SNS.

A government evaluation commission tasked to review the conduct of the Dutch Ministry of Finance and DNB with respect to SNS concluded in January 2014 that "from late 2008 to late 2011 responsibility for a radical and imperative restructuring was primarily placed with the management board and the supervisory board of SNS". Whilst the boards took action to wind down international operations in 2010, this did not address the bank's overall fragility and did not get close to the full capital restructuring that would have been necessary at that time.

In 2011, DNB finally chose to play a more active role, but it still took more than a year before SNS was nationalised. Both the bank and DNB failed to realise the full size of write-downs required with regards to SNS' property portfolio, resulting instead in a series of write-downs over a number of years. As a result SNS continued to suffer from its weak financial position and the uncertainty from the real estate markets, and by the time DNB actively sought a restructuring solution, a private sector merger or acquisition or a capital injection had become highly unlikely.

DNB also considered splitting SNS in a good and bad bank, but given the number of deposit holders this was considered to be "operationally challenging". It was also thought that the result would be similar to a default in terms of generally weakening the Dutch financial sector and significant losses occurring for the Dutch government.

For the financial year ending 2012, SNS reported a E972 million loss, resulting in a E2 billion reduction in equity attributable to shareholders the equivalent of a 40% reduction of its capital base. DNB was therefore left with very few options and decided to implement its 'fall-back' scenario on February 1 2013.

The nationalisation of SNS was structured as follows:

- An expropriation of shareholders, holders of hybrid securities and subordinated creditors of SNS, including the E565 million of hybrid securities held by the Dutch government and around E1 billion of ordinary subordinated creditors;
- A E1.9 billion recapitalisation of SNS Bank in the form of ordinary shares;
- A E300 million recapitalisation of Reaal in the form of ordinary shares;



- A bridge loan of E1.1 billion to secure its short term funding needs; and
- A spin-off of the real estate finance activities into a 'bad bank' at a transfer price above market value, amounting to additional aid of E859 million.

Notably, following the decision to nationalise SNS, the Dutch finance minister said that the intervention act did permit the expropriation of senior bondholders, even though parliamentary proceedings had indicated that expropriation powers were limited to equities and equity like instruments. Had DNB gone further and taken action to expropriate senior bondholders, it could have impacted the cost of borrowing for the wider Dutch financial industry.

Nevertheless, as bail in provisions become available throughout Europe, and given the finance minister's comments on a possible bail in of senior SNS bondholders, such a move cannot be excluded in the future.

Following the financial crisis many jurisdictions enacted legislation to increase regulatory powers to resolve failing banks. The BRRD seeks to harmonise these powers across European jurisdictions. However, the SNS case demonstrates that resolution tools alone are insufficient to deal with a still fragile European financial industry.

Failures occurred in the early 2000s when SNS became overexposed to the real estate while the market was at its peak. When the real estate market in the US collapsed, followed by issues in SNS' home market, the full extent of the problem was not recognised, resulting in write downs over a number of years without any meaningful restructuring.

Exposure to real estate of both the banking and the insurance arm increased SNS' overall risk. Furthermore, insufficient procedures were in place for a transfer of guaranteed deposit accounts. As a result the bank could not be allowed to fail, and chances for a private sector merger or the transfer of SNS' valuable assets in a 'good bank' were limited.

The implementation of BRRD planning and preparation measures might have helped DNB to realise the explosive potential of SNS' structural issues more quickly. Instead, it took the central bank more than a year from the point it became actively involved to the nationalisation of SNS.

If utilised properly, it would seem that European regulators are moving in the right direction to ensuring the stability of the European banking system. Basel III seeks to strengthen bank balance sheets and will make banks more robust in the future. The comprehensive assessment is expected to reduce the likelihood of banks being overexposed to particular sectors and to provide more transparency into the true quality of banks' balance sheets. And the preparation and prevention provisions contained within the BRRD will provide a comprehensive plan for restructuring financial institutions so that decisive action can be taken early in order to minimise loss to taxpayers and also investors.

Whilst the possibility of future bank failures cannot altogether be ruled out, the BRRD should provide regulators with a powerful tool to both reduce the number of such failures and reduce systematic knock-on effects.

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