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Legal developments in 2014 relevant to Dutch group finance companies

Below you will find a summary of legal developments in the Netherlands for 2014 and beyond which are relevant to Dutch group finance companies ('finco's') used by domestic or international conglomerates. The developments relate to changes in the conditions to remain eligible for the exemption from bank license requirements, the preparation of financial statements and auditor rotation requirements. These are mainly driven by anti-abuse measures and/or the implementation of EU legislation. The status and timing will be indicated per development.

Proposed amendments to the banking license exemption regime for finco's

Summary of the current rules

Currently, finco's are exempt from the bank license requirement provided that, in short, their borrowings from retail investors are done by issuing debt securities (in accordance with primary market requirements) and guaranteed by a parent company (a bank guarantee or a keep well-agreement between parent company and the finco may be chosen as an alternative) and at least 95% of all monies borrowed (both from retail and otherwise) by the finco are on-lent or invested within the group of which it forms part. If the finco on-lends all its borrowings to another group company, that company is entitled to use those funds for any purpose.

Initial proposal

In August 2013 the Dutch government issued a consultation draft of a bill to amend the Dutch Financial Supervision Act (*Wet op het financieel toezicht*) with effect from 1 January 2015, which included amendments to the exemption conditions. These proposals were intended to prevent abuse outside the bonafide international corporate community. However, they would have had an adverse effect on the sizeable/large finco population in the Netherlands. The industry and services providers responded to the consultation, which led the government to amend the draft prior to submitting a formal bill to parliament, thus significantly reducing the side effects for finco's.

Key issues

- Amendments to the existing bank license exemption for Dutch group finance companies will mostly affect finco's that are part of non-EU banking groups
- Consolidation requirement for finco's that are also intermediate holding companies
- Annual accounts inconsistency with EU Transparency Directive removed
- Introduction of compulsory auditor rotation for finco's with listed debt

Below we discuss the initially proposed rules and finally the most recent version of the draft Bill (the 'final proposal').

Summary of initial proposal

The new rules, as initially drafted by the Ministry of Finance, would have significantly amended the current provisions and also have given them extraterritorial effect:

- A guarantee by the parent company (or bank guarantee) would always be required. It would not be sufficient to have a keep-well agreement in place.

- Next to the parent or bank guarantee it would always be necessary that the parent company would be able to fully ensure timely payment by the finco of its retail funding debts.
- The exemption would cease to apply if one or more group companies of the finco (whether Dutch or non-Dutch) would lend more than 5% of the total borrowed monies outside the group (which includes having monies in a bank account) ***regardless*** of whether that group company actually borrowed from the finco.
- The exemption would also cease to apply if one or more group companies of the finco (whether Dutch or non-Dutch) would regularly engage in the business of making loans (regardless of the amount) outside the group. This would have affected any Dutch finco which is affiliated with an entity engaging in banking, consumer finance, dealer finance, customer finance, leasing etc.
- The finco would have to inform the Dutch Central Bank ('DCB'), at its request, about the way in which its parent company had ensured that it could actually fulfil its obligations under the parent guarantee and keep-well agreement at any time.
- Any company (whether Dutch or non-Dutch) which borrows monies from the finco would have to inform the DCB, at its request, about its use of the borrowed monies.
- If information requests of the DCB (see foregoing bullet-points) would not be honoured within three months following the deadline imposed by the DCB, the finco would no longer have the benefit of the exemption and become subject to the bank license requirement.

The initially proposed rules would first of all have extended the current maximum allowance of 5% of total borrowings for external lending to all group companies of the finco (including its parent), regardless of whether they borrowed from the finco. Thus, if €100 million would be the finco's total borrowing, no other group company could have more than €5 million outstanding to non-affiliated entities (not even in the form of a credit balance on a bank account). In addition, if any group company would make ***any*** loans outside the group on a regular and consistent basis, whether by lending to consumers or corporates (also including leasing activities), the finco would lose its exempt status and become subject to the bank license requirement. Hence, from 1 January 2015 finco's affiliated with one or more financial institutions would no longer have been able to issue bonds or notes to retail investors.

Summary of the final proposal

We have received a draft of the final proposal but are not entitled to circulate it outside the firm except by providing summary information. Accordingly, the below focuses on the highlights of the final proposal:

- The extraterritorial scope of the 5% maximum allowance of total borrowings has been removed in the final proposal.
- A keep-well agreement is acceptable as an alternative to a parent company guarantee.
- Next to a parent company guarantee or keep-well agreement the parent company must also ensure that it is at all times able to support the finco in meeting its obligations under the retail funding instruments. It is incumbent on the finco to demonstrate, when asked by DCB, that this is the case.
- The exemption ceases to apply if the group has as its main business the extension of credit to non-affiliated entities, except if the parent company or the entity to which the finco has actually on-lent the proceeds is a Dutch or EEA licensed bank.

This last change is good news for finco's which are affiliated with:

- industrial or commercial groups which happen to have a bank, consumer finance, dealer finance, customer finance, or leasing entity in the group but where external financing is not their main activity, or
- a financial or banking group provided the ultimate parent or the entity to which the finco on-lends is an EEA licensed bank.

This leads to the conclusion that only the requirement that the parent company ensures that it is at all times able to support the finco in meeting its obligations under the retail funding instruments, might create some difficulties; the Ministry of Finance seems to be concerned by parent guarantees or keep-well agreements that are meaningless in practice (even though the rules will continue to require that the parent company must have a positive consolidated shareholders equity during the life of the guarantee or keep-well agreement). It is unclear how the finco is to demonstrate to DCB's satisfaction that this requirement can be met. It is to be hoped that this rule will either not survive the legislative process or be clarified. The final proposal is

expected to be published and submitted to parliament within the next few months. Its planned entry into effect is 1 January 2015.

Requirement to prepare sub-consolidated accounts for finco's with listed debt

Current exemption

For accounting purposes finco's that are also intermediate holding companies (ie have subsidiaries) currently apply an exemption under Dutch GAAP (Article 2:408 Dutch Civil Code), which allows them not to prepare consolidated financial statements if the financial data that they should consolidate, has been included in the consolidated financial statements of a larger group.

End of the exemption on 1 January 2015

Recently accepted changes to the Dutch accounting legislation will require that finco's that have subsidiaries and have debt securities admitted to trading on a regulated market in any EEA Member State (or equivalent outside the EEA) prepare consolidated financial statements and can no longer apply the exemption of Article 2:408. The changes will take effect on 1 January 2015 and will then require a consolidation starting upon the first semi-annual accounting date (ie 30 June 2015) with comparable figures per 31 December 2014.

Amendment in corporate law to remove inconsistency following implementation of EU Transparency Directive for finco's with listed debt

Per 1 January 2014 a new rule removes an inconsistency caused during the implementation of the EU Transparency Directive. Dutch corporate law is now brought in line with the financial regulatory rules implementing the Transparency Directive (save for a painful glitch). As a result BV companies may not take more than four months for drawing up their annual financial statements if their securities are listed or admitted to trading on an EEA regulated market or a non-EEA equivalent. However, if such an issuer only has non-equity securities with a denomination of at least €100,000 listed or admitted to trading, then it is unclear whether the exemption for such an issuer under the EU Transparency Directive regime applies or the stricter rule under Dutch corporate law. The Ministry of Finance has informally admitted that the new corporate law rule should have referred to the high denomination exception but erroneously it does not. We are told the error will be corrected by amending legislation which will not take effect before the end of the year. Until such time finco's should seek guidance from their accountants as to the proper course of action.

Compulsory auditor rotation for finco's with listed debt

Mandatory eight year auditor rotation

Ahead of upcoming EU legislation, there is a new Dutch law, applicable from 1 January 2016, which provides that an auditor cannot conduct the statutory audit of a "public-interest entity" ('PIE') during a two year period starting from the date at which it has conducted the statutory audits (or has taken care of or has set up the financial administration for a substantial part) for the relevant PIE for the previous eight (consecutive) years. Effectively therefore, this new law requires PIEs to rotate auditors every eight years.

Effect for finco's

The definition of PIE includes Dutch banks and insurance companies but also Dutch entities whose debt or equity securities are admitted to trading on a regulated market in any EEA Member State. Many finco's have debt securities listed on the regulated market of an EU stock exchange and therefore are a PIE.

The new legislation is being introduced such that a company that is a PIE on 1 January 2016 is required to switch immediately if it has had the same auditor since 2008 (or is required to switch by 2017 if it has had the same auditor since 2009 etc). There is no transitional period, as the period between the adoption of the law and 1 January 2016 was intended to allow companies to change auditors prior to the new law coming into force.

Potential impact of upcoming EU legislation

As noted above, the Dutch law has been enacted ahead of proposed EU legislation on this topic. In December 2013 it was reported that a deal between the EU Member States and the European Parliament had been reached on proposals which included a limit on retaining the same auditor for ten years with an extension possibility of another ten years. These limits will be minimum requirements, thus allowing EU Member States to be more restrictive. The proposals also include blacklisting of certain advisory services as well as a cap on advisory fees if the client is also audited by the same firm. A plenary vote in the European Parliament will take place in early 2014, with the legislation coming into force around 2016. It is not yet clear exactly what the EU legislation will require, nor has the form

of any transitional arrangements been determined at this stage.

Certain members of the Dutch Parliament have criticized the new Dutch law and argued that the Dutch Government should have waited for the EU requirements to come into force or at least have been settled prior to bringing in this legislation. In response, the Minister of Finance has noted that he will inform parliament of developments at the EU level in the summer of 2015, and if at that time it appears that this new Dutch requirement would conflict with the EU rules, this current Dutch rule would be amended and brought in line with EU legislation.

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