European Banking Union C:¹

Cross-Border Resolution—Fortis Group

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Abstract

In August 2007, Fortis Group, Belgium’s largest bank, acquired the Dutch operations of ABN AMRO, becoming the fifth largest bank in Europe. Despite its size and its significant operations in the Benelux countries, Fortis struggled to integrate ABN AMRO. Fortis’s situation worsened with the crash of the US subprime market, which impacted its subprime mortgage portfolio. By July 2008, Fortis’s CEO had stepped down, its stock had lost 70% of its value, and it was on the verge of collapse due to a severe liquidity crisis. The governments of Belgium, Luxembourg, and the Netherlands quickly came together and agreed to inject funding into the bank to keep it afloat. However, the deal fell apart when the Netherlands reversed course and nationalized Fortis’s Dutch assets. As a result, Fortis underwent an uncoordinated resolution, bifurcated along national lines. This case permits examination of this attempt at a cross-border rescue of a failing systemically important financial institution, analysis of why the effort failed, and consideration of how it might proceed differently under current regulations.

¹ This module is one of four produced by the Yale Program on Financial Stability (YPFS) considering the European Banking Union. Other modules are:
- European Banking Union A: The Single Supervisory Mechanism
- European Banking Union B: The Single Resolution Mechanism
- European Banking Union D: Cross-Border Resolution—Daxia

More information about the YPFS, including hyperlinked versions of some of the cases, are available at http://som.yale.edu/ypfs

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1. Introduction

On October 17, 2007, Fortis NV/SA, Belgium’s largest bank, partnered with the Royal Bank of Scotland and Banco Santander in a €72 billion deal to purchase ABN AMRO, a large but troubled Dutch bank. As a result, Fortis took over the Dutch operations of ABN AMRO and was transformed into Europe’s fifth largest bank with a strong presence in the Benelux countries (i.e., Belgium, the Netherlands, and Luxembourg). It was widely thought that the three banks overpaid for ABN AMRO, and Fortis soon began to struggle from the effects of the acquisition on its balance sheet. Its troubles were exacerbated as its mortgage portfolio was impacted by the crash of the US subprime market.

By July 2008, Fortis’s CEO had stepped down, and its stock had lost 70% of its value. By September of 2008, the bank was on the verge of collapse as it experienced a severe liquidity crisis. The governments of Belgium, Luxembourg, and the Netherlands came together and agreed to inject €11.2 billion into the bank. However, the deal fell apart when the Netherlands suddenly reversed course and nationalized Fortis’s Dutch assets. As a result, Fortis underwent an uncoordinated resolution along national lines, with the Belgian and Luxembourg governments pursuing different strategies than the Dutch government.

In this module, readers will examine the attempted cross-border resolution of Fortis. Readers should seek to identify weaknesses in the effort that might be avoided or minimized so as to achieve a more effective, coordinated result in the future. They should also seek to identify incentives that might strengthen cross-border resolution cooperation.

The rest of this module is organized as follows: Section 2 provides a brief history of the Fortis Group, Section 3 discusses the ABN AMRO acquisition, Section 4 describes the difficulty that Fortis had in integrating the ABN AMRO assets, Section 5 describes the joint resolution attempt and its dissolution, Section 6 concerns the regulatory reviews and events that occurred after the first resolution attempt, and Section 7 introduces some conclusions about what has been learned from the Fortis situation.

Questions

1. Should the Dutch, Belgian, and/or Luxembourg governments have done more to prevent or delay the acquisition of ABN AMRO, given the economic climate? What type of tools would they have needed?
2. Could the new European Single Supervisory Mechanism (SRM) have prevented the Fortis collapse?
3. What prompted the different responses from the Dutch, Belgian, and Luxembourg governments?
4. Did the governments act purely out of self-interest? Did they comply with the letter and spirit of European Union (EU) law?
5. What were the different strategies used by the Belgian and Dutch governments, and their results for depositors, counter-parties, shareholders, and taxpayers?
6. How do these results compare to what might have been achieved through a coordinated resolution under the new SRM?
7. Would the SRM have resulted in a more effective or simpler resolution?
8. What were the roles of the European Central Bank and the European Commission in the resolution?

2. History of Fortis

The Fortis Group was created in 1990 when AMEV, a large Dutch insurer merged with VSB Group, a Dutch banking group, and then later that same year joined with AG Group, a Belgian insurer. The
resulting company operated in both Belgium and the Netherlands through a complicated holding company structure and various subsidiaries. The transaction was the first cross-border merger in the European financial services industry and was heralded as a realization of the EU single market. In the following years, Fortis grew organically and through a series of aggressive acquisitions.

Beginning in 1998, Fortis’s two parent companies adopted identical management structures in an effort to better unify the company. Several additional initiatives were taken in the following years, including the switch to a single Board of Directors in September 2000,\(^5\) the launch in December 2001 of the single Fortis share—a new financial instrument that combined the shares of the two parent companies—\(^6\) and the amendment in 2004 of the two parent companies’ Articles of Association in order to create a more internationally oriented Board of Directors headed by a single Chairman. (Fortis 2006, 247)

By 2006, Fortis operated as a unified multinational business. However, its two parent companies, Fortis SA/NV (Belgium) and Fortis N.V. (the Netherlands), retained their independent status, and each was separately registered in its home country. Furthermore, each parent prepared its own financial statement in accordance with the legal and regulatory requirements of its home country. Together, the group also published a consolidated financial statement as required by Belgian law and a joint report of the Board of Directors of both parent companies. (See Figures 1 and 2 for more detail regarding Fortis’s governance structure.)

**Aggressive Growth**

The Benelux countries were Fortis’s home base and its strongest markets. However by 2007, Fortis had grown its business to operate in over 50 countries with almost 57,000 employees. Fortis operated in two segments: banking and insurance.

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\(^5\)“The governance structure of Fortis is such that a Fortis Board meeting is always a “two-in-one” event. Anyone observing such a meeting would see Board members participating in a single meeting to discuss issues and take decisions that relate to Fortis. From a legal point of view, however, two meetings have taken place.” (Fortis Governance Statement, English Version, January 2008, 9).

\(^6\)“When purchasing a Fortis share, shareholders effectively acquire a unit that comprises one ordinary Fortis SA/NV share and one ordinary Fortis N.V. share. As a consequence of this "Twinned Share Principle," the number of Fortis Shares issued is always equal to the number of Fortis SA/NV shares issued and also the number of Fortis N.V. shares issued. The Twinned Share Principle of Fortis is truly unique. It implies that a single unit represents a share in two legal entities, each with a different nationality. Shareholders have voting rights in both parent companies and may choose to receive a wholly Belgian-sourced or a wholly Dutch-sourced dividend.” (Fortis Governance Statement, English Version, January 2008, 13).
Fortis's banking operations included retail banking, offering a variety of deposit, credit and investment financial services to individuals and small businesses. Fortis also offered merchant and private banking services to a variety of clients, including large international companies, medium-sized enterprises, public sector entities, and high-net-worth individuals.

Fortis’s insurance business offered a variety of products, including life, healthcare, and disability insurance products, as well as mortgage and savings instruments. Besides branches of Fortis Bank, the company sold these products through a variety of channels, such as independent agents, brokers, and financial planners. (Fortis 2006, 111-112)

As shown in Figure 3, in 2007, after the ABN AMRO acquisition, Fortis reported $121 billion in revenue and a record $5.5 billion profit, on assets of $1 trillion.

Regulation and Supervision

Fortis was subject to regulatory supervision at the consolidated level and at the individual operating company level. At the consolidated level, the Belgian Banking, Finance, and Insurance Commission and De Nederlandsche Bank (the Dutch Central Bank [DCB]) supervised Fortis jointly. Since its banking activities, headquartered in Brussels, were the largest part of the organization, the Belgian authority was considered the “consolidating and coordinating supervisor” (primary) for EU purposes. Fortis’s banking subsidiaries had to comply with the regulations in the countries where they operated. (Fortis 2006, 87). The group was listed on the Euronext Brussels, Euronext Amsterdam, and Luxembourg stock exchanges and had a sponsored ADR program in the United States.

Later, the Basel Committee on Banking Supervision would find that “Fortis was deemed to be systemically relevant in the three countries (Belgium, the Netherlands, and Luxembourg), not only because of its large positions in domestic markets, but also because of its function as a clearing member at several major domestic and foreign stock exchanges.” (Basel Committee 2010, 16) As shown in Figure 4,
Figure 3: Fortis Key Indicators 2005-2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenues*</th>
<th>Profits (After tax)*</th>
<th>Profits/Revenues</th>
<th>Assets*</th>
<th>Common Equity*</th>
<th>Equity as % assets</th>
<th>Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>75,518</td>
<td>4,177</td>
<td>5.5%</td>
<td>775,636</td>
<td>19,525</td>
<td>2.5</td>
<td>50,846</td>
</tr>
<tr>
<td>2006</td>
<td>112,351</td>
<td>4,896</td>
<td>4.4%</td>
<td>859,900</td>
<td>22,328</td>
<td>2.6</td>
<td>54,245</td>
</tr>
<tr>
<td>2007</td>
<td>121,202</td>
<td>5,459</td>
<td>4.5%</td>
<td>1,022,256</td>
<td>27,222</td>
<td>2.7</td>
<td>56,886</td>
</tr>
<tr>
<td>2008</td>
<td>164,887</td>
<td>5,467</td>
<td>3.3%</td>
<td>1,273,717</td>
<td>48,317</td>
<td>3.8</td>
<td>62,009</td>
</tr>
</tbody>
</table>

*All numbers in millions of US dollars.

Figure 4: Fortis Group Assets vs. Belgium and The Netherlands GDPs 2005-2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets*</th>
<th>Assets as % of Belgium GDP</th>
<th>Assets as % of Netherlands GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>775,636</td>
<td>252</td>
<td>145</td>
</tr>
<tr>
<td>2006</td>
<td>859,900</td>
<td>212</td>
<td>125</td>
</tr>
<tr>
<td>2007</td>
<td>1,022,256</td>
<td>190</td>
<td>112</td>
</tr>
<tr>
<td>2008</td>
<td>1,273,717</td>
<td>285</td>
<td>166</td>
</tr>
</tbody>
</table>

*All numbers in millions US dollars.

The size of Fortis’ balance sheet exceeded that of Belgium and the Netherlands, which would prove challenging when the bank needed assistance.

3. The ABN AMRO Acquisition

In October 2007, Fortis acquired the Dutch operations of ABN AMRO, the second-largest Dutch bank, as part of a three-party consortium that included the Royal Bank of Scotland (RBS), as lead, and the Banco Santander (Spain). At the time, ABN AMRO was listed in the Fortune Global 500 as the 15th largest bank in the world. ABN AMRO had operations in 63 countries and 110,000 employees.

The bid by the consortium was a hostile one. The ABN AMRO board had preferred an offer by Barclays, largely because of Barclays’s intent to maintain most of the bank intact. The Barclays offer also was surprisingly favored by the Dutch Central Bank, according to press reports in February of 2007. (See Trenor 2007) Just as Barclays’s exclusive period expired, the consortium made a higher bid but proposed breaking up the bank. The consortium’s bid was favored by The Children’s Investment Fund Management (TCI) hedge fund, a major ABN AMRO shareholder. With TCI’s support, the consortium secured a favorable vote at the shareholders’ meeting.
<table>
<thead>
<tr>
<th>Entity</th>
<th>Royal Bank of Scotland</th>
<th>Fortis Group</th>
<th>Banco Santander</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>€27.2 billion</td>
<td>€24 billion</td>
<td>€19.9 billion</td>
</tr>
<tr>
<td>Businesses Acquired</td>
<td>North American operations + global warehouse customers</td>
<td>Dutch operations, including the private banking and asset management functions + commercial and mortgage loan divisions.</td>
<td>Latin American and Southern Europe operations</td>
</tr>
<tr>
<td>Home Country</td>
<td>United Kingdom</td>
<td>Belgium/the Netherlands</td>
<td>Spain</td>
</tr>
<tr>
<td>Supervisor</td>
<td>Bank of England</td>
<td>Belgian Banking, Finance, &amp; Insurance Commission, Dutch Ministry of Finance + Dutch Central Bank</td>
<td>Bank of Spain</td>
</tr>
</tbody>
</table>

*Source: Algemene Rekenkamer 2009-2010.*

In the end, the Consortium bid €71 billion for ABN AMRO, an amount that many analysts believed was too high (see Figure 5).

Fortis put up €24 billion (cash). The bank financed its participation “through the issuance of new shares, convertible bonds, hybrid instruments, divestment and capital relief transactions (securitizations) … In addition, it arranged a borrowing facility of €10 billion as bridging financing.” (DCB, Fortis Letter, 5) In exchange, Fortis took over ABN AMRO’s Dutch operations, including the private banking and asset management functions, strengthening its position in those markets. Fortis also acquired the commercial loan and mortgage loan divisions.

**Approval by the Dutch Authorities**

Because the proposed transaction would combine the first and fourth largest banks in the Dutch commercial banking market, it was subject to review and approval by the DCB, which was also the bank supervisor, and the Dutch Ministry of Finance. Both Fortis N.V. (Netherlands) and ABN AMRO were of vital importance to the Dutch financial sector because of their size, the nature of their activities, and their roles in the interbank market and payments.

The DCB found that problems at either or both institutions could have generated system-wide effects, and that those effects could be intensified with the consolidation of the two entities. The DCB also found that the intended two- to three-year timeframe for splitting up ABN AMRO created the risk that conflicts of interest could develop between the parties, causing further stress to the financial industry. The DCB also took special note of the looming financial crisis and liquidity problems then being experienced by banks that might negatively impact any or all of the involved banks, and found that the transaction “could jeopardize the financial stability of the nation’s financial sector.” (See Appendix A for the DCB’s analysis of systemic risk.)

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7 “From a prudential point of view, an offer by a consortium would constitute a strong risk-increasing and complicating factor, both in the preparation of the transaction and in its execution and implementation.” Dutch Central Bank, 2007.
However, despite its finding of jeopardy, ultimately, the DCB found no legal basis for halting the deal. Rather, to mitigate the identified risks, the DCB imposed a number of conditions on the consortium.\textsuperscript{8} On September 17, 2007, it advised the Ministry of Finance to issue a declaration of no-objection for the proposed transaction, subject to its stated conditions. The Ministry issued a declaration of no-objection the same day. (For further details see the \textit{DNC\_Fortis\_Letter} and the \textit{DNC\_RBS\_BS\_Letter}.)\textsuperscript{9}

\textbf{European Commission Approval}

The merger was also required to pass scrutiny under EU merger regulations. Upon review, the European Commission concluded that the acquisition of assets by RBS and Santander would not impede effective competition in the European Economic Area. However, the Commission concluded that the acquisition by Fortis presented competitive issues regarding the concentration in commercial banking. The Commission required Fortis to divest certain of its commercial banking units before proceeding with the deal. Fortis sold these units at a €300 million loss. \textit{(European Commission, IP/07/1442)}

\textbf{4. A Difficult Integration}

Soon after the acquisition, Fortis began to struggle. The bank delayed fully integrating ABN AMRO assets for several reasons. First, it had acquired a great amount of intangibles that it could not put on its balance sheet and would have to write off. Second, if it fully integrated ABN AMRO, it would be in danger of no longer satisfying its capital requirements. Additionally, it had to contend with the €300 million loss from the EU-required sale of assets that it had to recognize. Fortis’s troubles were exacerbated as its subprime mortgage portfolio was being impacted by the crash of the US subprime market.

To finance the purchase, Fortis raised €13.4 billion in October 2007 by issuing extra shares to existing shareholders at a discounted price of €15 per share. In November 2007, Fortis reported an unexpected decline in third-quarter profits and disclosed that it had “some exposure” to the US subprime market through its holdings of mortgage-backed and asset-backed securities and collateralized debt securities. Despite this, it managed to sell an additional €2.5 billion in bonds to help fund the ABN AMRO acquisition.

However by June 2008, Fortis’s situation had weakened. The bank announced that because of the financial crisis it needed to fortify its capital by raising an additional €8.3 billion and paying its much coveted dividend in stock instead of cash (saving €1.5 billion). The move caused an uproar among shareholders because the dividend had been one of the main selling points of the shares. Fortis stock dropped from €12 to €10 on June 26, 2008 and then further declined.

On June 26, 2008, Standard & Poor’s put the company on “credit watch with negative implications” citing the bank’s “increasing reliance on weaker forms of capital.” \textit{(The New York Times, 2008A)} After further review, on July 17, it lowered the ratings on Fortis’ core operating groups and subsidiaries. \textit{(Reuters, 2008)}

\textsuperscript{8} For example, the Consortium was required to submit a transition plan for approval within 45 days after the deal closed. \textit{DCB RBS/Santander\_letter, Annex 2.}

\textsuperscript{9} The UK Financial Services Authority was also criticized for not taking steps to halt the “calamitous” deal which amounted to €27.2 billion on The Royal Bank of Scotland’s part. It was later determined that the deal reduced RBS’s capital cushion to just 2%, which precipitated its failure as the financial crisis developed. It had to be rescued by the UK government beginning in October 2008. As of year-end 2013 the government had invested £45.5 billion (£27.2 billion) and still owned 79%. \textit{(HeraldScotland, October 2012; www.rbs.com)}. Additionally, in 2013, the FSA was terminated as a separate agency.
The company finally managed to issue 150 million shares to large investors at €10 a share, placing them with Libyan and Chinese investors after giving a 25% discount. Belgian shareholders (holding a combined total of 15 percent) were not allowed to participate, a situation that was not well-received.

Despite further attempts to calm the waters, on July 11, 2008, Fortis CEO, Jean-Paul Votron stepped down, conceding that the ABN AMRO acquisition had depleted Fortis’s capital. Its stock closed at just half of what it had been prior to the acquisition.

During the summer, customers continued to withdraw funds, and Fortis experienced a worsening liquidity crisis. By September 2008, Fortis was on the verge of collapse and the subject of bankruptcy rumors, no doubt fueled by the September 14 run on Northern Rock UK plc (the UK’s first bank run in 150 years) and the bankruptcy filing of Lehman Brothers in the US the next day. During the last week of September, Fortis’ share price fell 35%, to hover around €5. On September 25, CEO Verwilst tried to reassure analysts that the company was sound, but without offering concrete numbers had little impact. He stepped down that evening and was replaced by Filip Dierckx.

5. The Resolution Attempt

On Sunday, September 28, 2008, DCB Chief Nout Wellink and Dutch Finance Minister Wouter Bos travelled to Brussels for talks with the Belgian government and regulators. The two Dutch officials had not considered the meeting a formal get-together, but wanted to meet with the Belgians about the problems that Fortis was having and to consider solutions. Although ING and BNP Paribas had expressed interest in buying the group, no concrete offer had been made.

When Wellink and Bos arrived at the offices of the Belgian minister, to their surprise, there was a “war council” in progress. Present were: Belgian Prime Minister Yves Leterme, Belgian Finance Minister Didier Reynders, French Finance Minister Christine Lagarde, European Central Bank President Jean-Claude Trichet, Fortis CEO Dierckx and two Fortis directors. The talks were well underway, and specific numbers were being discussed. (De Standaard 2008)

The three governments worked out an emergency plan to save Fortis by partially nationalizing it, agreeing to inject €11.2 billion into the failing bank. As detailed in Figure 6, Belgium would pay €4.7 billion for 49% of the Belgian holding company, which was the parent of the Belgian bank and the profitable insurance subsidiary. Luxembourg would pay €2.5 billion for 49% of the Luxembourg banking subsidiary. And the Netherlands would contribute €4 billion for a 49% interest in the Dutch banking subsidiary. (See The Telegraph, dated September 28, 2008.)

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10 Fortis was led by a number of CEOs from 2000-2008, which lead to a lack of leadership continuity. Anton van Rossum joined Fortis as CEO in 2000, Jean-Paul Votron, replaced him in 2004, and engineered the company’s purchase of ABN AMRO, a company that he had briefly worked at. Votron resigned in July 2008 after the company’s stock had lost 70% of its value during the year. He was succeeded by an interim CEO, Harman Verwilst, who had been with the company since 2004. Filip Dierckx, who had been responsible for growing Fortis’ subprime mortgage business then replaced Verwilst in July 2008.

Figure 6: Fortis Resolution Plan I (September 28, 2008)

<table>
<thead>
<tr>
<th>Country</th>
<th>Belgium</th>
<th>the Netherlands</th>
<th>Luxembourg</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>€4.7 billion</td>
<td>€4 billion</td>
<td>€2.5 billion</td>
</tr>
<tr>
<td>Interests Acquired</td>
<td>49% of Belgian holding company including Belgian bank and insurance businesses</td>
<td>49% of Dutch banking subsidiary</td>
<td>49% of Luxembourg banking subsidiary</td>
</tr>
<tr>
<td>Supervisor</td>
<td>Belgian Banking, Finance and Insurance Commission</td>
<td>De Nederlandsche Bank</td>
<td>Central Bank of Luxembourg</td>
</tr>
</tbody>
</table>

The Dutch Reversal

Upon returning home, the Dutch officials grew upset with not having been invited to the meeting and with the deal that they had made. They believed that the Belgians were getting a better deal, since they would acquire ownership of the lucrative Belgian and Dutch insurance subsidiaries. As a result, the Dutch decided to pursue a different strategy.

On October 3, the Dutch government announced that it had nationalized Fortis’s Dutch assets in order to reassure Dutch depositors and safeguard the country’s financial market. The government acquired a 92.6% interest in Fortis Bank Nederland Holding, a 100% interest in Fortis Insurance Netherlands NV, a 100% interest in Fortis Corporate Insurance, and a 70% interest in Fortis FBN (H) Preferred Investments BV, paying €16.8 billion for these shares. (New York Times 2008) The Dutch government also repaid €34 billion in short-term loans to Belgium Fortis and accepted liability for €16.1 billion of outstanding long-term loans.12 Reports indicated that the Netherlands’s government never paid its original commitment, and some critics felt that this had contributed to Fortis’s continuing troubles, as it had experienced depositors’ withdrawals and lenders unwilling to lend even after the announced plan. (See the DCB Press Release.)

The Belgian and Luxembourg Response

In light of the actions of the Dutch government and to stave off a run on Belgian Fortis, the Belgian and Luxembourg governments scrambled to regroup. Two days later, on October 5, 2008, they announced the following “Additional Measures,” amounting to a revamped rescue plan:

- For an additional capital injection of €4.7 billion, the Belgium government would acquire additional shares of Fortis Banque Belgium, bringing its total interest to 99.93%.
- The Belgian government also agreed to transfer 75% of its interest in the Fortis Belgian bank and 67% of the Luxembourg bank to the French bank BNP Paribas for €8.25 billion in stock, which was later renegotiated to €11 billion. As a result, it retained a 25% interest in Fortis Bank (sufficient to block shareholder action) and became a 12% shareholder in BNP Paribas, making the Belgian government its largest shareholder.

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12 In December 2008, the Dutch government also acquired a 33.8% interest in the ABN AMRO assets acquired by the Fortis Group as a result of the Consortium purchase for an additional €6.54 billion. The government also provided ongoing treasury financing, up to €45 billion, to the Dutch Fortis operations, a function that Belgian Fortis had previously served. (Algemene Rekenkamer, 6).
The Luxembourg government would acquire a 1.1% share in BNP Paribas.

Since BNP Paribas insisted that it would not take on Fortis’s toxic assets, a portfolio of these assets, valued at €10 billion, would be transferred to a special-purpose vehicle that would be owned and financed by the Belgium government (24%), BNP Paribas (10%) and by Fortis Group, which held the ABN AMRO assets (66%).

BNP Paribas would purchase the Belgian insurance activities of the Fortis Group.

The Fortis Group would continue to own Fortis Insurance International and 66% of the structured products vehicle, and it would also benefit from the sale of Fortis Insurance Netherland and Fortis insurance Belgium. (Belgium Government, 2008)

6. The Aftermath and EU State Aid Review

EU State Aid Review

Under the laws of the EU, the governments of the member states are prohibited from injecting funds into private companies so as to give them an unfair advantage. However, the laws do recognize that some government assistance may be necessary, and such “state aid” is permitted for reasons of general economic development, subject to EU review.

In reviewing the Fortis situation, the EU Commission found that the actions by the Belgian and Luxembourg governments in intervening to support Fortis constituted state aid to the benefit of Fortis Bank and Fortis Bank Luxembourg. However, the Commission concluded that the aid was compatible with EU laws because it was necessary to save the banks and to remedy a threat to the financial system—“Given Fortis Bank’s size, market share in the retail sector, and the prevailing crisis on the financial markets, the bank’s collapse would have given rise to a systemic risk to the financial sector.” (European Commission (IP/08/1884) The Commission approved the Belgium/Luxembourg support package on December 3, 2008, also finding that the sale to BNP Paribas did not involve state aid since it paid a market price.

Review by Belgian Court

Shortly after the resolution plans were announced, Belgian shareholders of Fortis Group sued to stop the sale to BNP Paribas. On December 12, 2008, the Court of Appeal of Brussels decided that the sales to the Dutch and Belgian governments, as well as the subsequent agreement to sell to BNP Paribas, were not valid under Belgian law because they had not been submitted to the Fortis shareholders.13 This left the deal open to renegotiation. The shareholders initially rejected the resolution plans at meetings in Belgium and the Netherlands, but after certain transactions were changed, the plans were approved at a second general assembly of shareholders held on March 12, 2009.

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13 It is worth noting that the Belgian government opposed the ruling, and a controversy ensued when certain persons attempted to influence the court’s ruling and also to circumnavigate the ruling’s effect. In the country’s climate of political turbulence (which had already been agitated by the Dutch nationalization of part of Fortis), charges of interfering with the judiciary were brought, an investigation was undertaken, and ultimately the Minister of Justice, Prime Minister Leterme, and the government resigned over the Fortis affair. (Blenkinsop 2008).
Key changes in the deal were:

- BNP Paribas increased its price to €11.2 billion.
- Belgium would retain a 25% blocking vote in Fortis Belgium.
- Rather than acquire all of Belgian insurance business, Belgium acquired only 25%.
- A redistribution of the cost of the Special Purpose Vehicle, now valued at €11.8 billion,
  - 11.76% (€1.39 billion) share by BNP Paribas,
  - 43.53% (€5.13 billion) by the Belgian government, and
  - 44.71% (€5.28 billion) by Fortis Group. (BNP Paribas 2009).

EU State Aid Redux

In its December ruling, discussed above, the European Commission determined that the purchase of Fortis Insurance Nederland N.V. by the Dutch government did not constitute state aid. On April 9, 2009, the Commission opened a formal investigation into the question of state aid regarding the original...
nationalization of the Dutch bank, the subsequent purchase of the Dutch ABN AMRO banking assets (ABN AMRO Bank N.V.), the provision of tens of billions of euro in financing, and the plans of the government to merge the banks into a new entity. (European Commission, IP/09/565)

On February 8, 2010, the Commission temporarily approved the Dutch plans to merge the two banks as “urgent rescue aid,” while it continued to investigate the overall Dutch activities. (European Commission, IP/10/138) In July 2010, the Dutch bank operations were merged to create the current ABN AMRO Group N.V.

On April 5, 2011, the Commission finally approved all Dutch support activities as being “in line with EU rules that allow aid to remedy a serious disturbance in a member state’s economy.” (European Commission, IP/11/406) As of October 2014, the Dutch government still owned ABN AMRO Group, which is an operating commercial bank, one with $533 billion in assets. (SNL Financial). The government has indicated intent to sell the company to private investors sometime in the future.

Meanwhile, the Fortis insurance operations (previously Fortis Holding) were not purchased by BNP Paribas but were renamed Ageas in 2010 and continue to operate out of their Brussels headquarters.

BNP Paribas remains one of the largest banks in the world and survived the financial crisis fairly well, delivering profit of €3 billion in 2008 and €5.8 billion in 2009. It was ranked 4th overall on SNL Financial’s list of the world’s 100 largest banks with $2.512 trillion in assets (December 2013). (SNL Financial)

7. Lessons Learned

In March 2010, the Basel Committee on Banking Supervision, a committee of the Bank for International Settlements, issued Report and Recommendations of the Cross-Border Bank Resolution Group that included an analysis of the Fortis, Dexia (Belgium), Kaupthing (Iceland), and Lehman Brothers (US) resolutions. The report highlighted the shortcomings of the cross-border crisis resolution frameworks among the European member states and cited “group structure, liquidity and information sharing among supervisors as examples where improvements are needed.” (Basel Committee 2010, 10)

Specifically with respect to the Fortis resolution the Committee made the following findings:

- The Fortis case illustrates the tension between the cross-border nature of a group and the domestic focus of national frameworks and responsibilities for crisis management. This leads to a solution along national lines, which did not involve intervention through statutory resolution mechanisms;
- The usefulness of formal supervisory crisis management tools appears to be limited in a situation where the institution needs to be stabilized rapidly and, at the same time, the continuity of business needs to be ensured in more than one jurisdiction. For example, some formal tools, when disclosed, can further undermine market confidence or may trigger termination and close-out netting events in financial contracts, with counterproductive effects;
- The Fortis case illustrates the tension between the need to maintain financial stability, for which a bank, under certain circumstances, needs to be resolved in the public interest and with public support, and the position of the shareholders of such a bank (i.e. dilution of their stake). Currently, Dutch and Belgian financial supervisory legislation does not permit effective special measures to be taken to resolve individual banks in a manner which maintains financial stability in urgent situations and which overrides the rights of shareholders;
Despite a long-standing relationship in ongoing supervision and information sharing, the Dutch and Belgian supervisory authorities assessed the situation differently. Differences in the assessment of available information and the sense of urgency complicated the resolution. (Ibid., 11)

The Committee’s recommendations informed the recent changes in EU bank supervision and resolution laws. These include EU-level supervision and resolution of significant cross-border banks such as Fortis Group, utilizing a single rulebook of regulations and a uniform set of resolution tools, and increased cross-border cooperation and information sharing.

It cannot be known what impact the new EU banking regulations would have on Fortis’s situation. However, it seems likely that Fortis would have been designated a significant bank under the new Single Supervisory Mechanism, subject to direct supervision by the European Central Bank (working closely with the National Supervisory Authorities of its host countries). Since under the new regime there is a mandate to consider systemic risk issues, perhaps the ECB might not have approved the ABN AMRO deal in late 2007, or may have at least delayed it.

If the merger had been approved, the rescue and resolution of Fortis might have gone differently under the Single Resolution Mechanism, with the original plan being adhered to and funded through the ECB, not subject to the whims of individual countries. At least, there would have been a mechanism in place to ensure that all interested parties were invited to any “war council,” so that, from the beginning, an arguably more collaborative and fairer process would have been employed.

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Yale Program on Financial Stability Case Modules

More information about the YPFS, including hyperlinked versions of some of the cases, are available at [http://som.yale.edu/ypfs](http://som.yale.edu/ypfs)


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Appendix A: DCB’s analysis of systemic risk.

UNOFFICIAL TRANSLATION
In the event of variance between the English translation and the Dutch original, the latter shall prevail.

Minister of Finance
Prinses Beatrixlaan 512
2595 BL DEN HAAG

Date
17 September 2007

Dear Mr Bos,

With regard to the intention of The Royal Bank of Scotland Group Plc (RBS), Banco Santander Central Hispano S.A. (Santander) and Fortis N.V./Fortis S.A. (Fortis) – hereafter jointly referred to as the Consortium – to take over and, subsequently, split up ABN AMRO Group, DNB has investigated the possible effects thereof on financial stability. The envisaged transactions could jeopardize the financial stability, which would be an undesirable development for the financial sector. The fact is that by the envisaged transactions two undertakings are involved which because of their size, the nature of their activities and their roles in the interbank market and payments are of vital importance for the Netherlands and the Dutch financial sector. Problems at either or both institutions might generate system-wide effects.

Before discussing our investigation, we refer to the current situation on the international financial markets. Presently, signs increasingly point to a serious disruption of the global financial system, as internationally operating banks have substantially increased liquidity needs and therefore hoard liquidity. As a consequence, the international money market for maturities from one week onward is not functioning well at the moment. Banks’ uncertainty about their future liquidity needs arises from the deteriorated market climate for credit products. As a result, banks feel increasingly compelled to provide funding again to special vehicles related to them (‘conduits’). The liquidity need potentially ensuing from this development is vast. The deficient functioning of the money market may have negative effects for all banks directly or otherwise involved in the envisaged acquisition. Therefore, there is a risk that the takeover process will become disorderly, which would harm the financial stability in the Netherlands.

We also note that the intended split-up, given its unique nature and complexity, calls for great care and enough time from the acquiring parties. At the same time, it is in the interest of the financial stability in the Netherlands that the duration of the period of uncertainty about the future of ABN AMRO Group be kept to a minimum.

From our analysis it emerges that there is an increase in financial stability risks. In the transition phase, in which ABN Amro Group is split up and the various business units of this institution are transferred to the Consortium partners, additional operational risks will arise as a result of the duration and complexity of the process indicated above. This underscores the importance of a careful and controlled disintegration and integration, also where the payments systems are concerned. The conditions and restrictions attached to the declaration of no objection applied for by the Consortium partners, as we advised in our letter pursuant to section 3:95 (3) of Wet Financiele Toezicht, seek to control these operational risks as much as possible.

Even if the Consortium partners comply with these instructions and restrictions, in the transition phase conflicts of interest may occur between the parties concerned or between business units of ABN AMRO Group and one or several of the new owners. If any such conflict occurs, the

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1 Netherlands Financial Services Act
interests of ABN AMRO Group may be impaired and the care required for the disintegration process may be jeopardised, which could adversely affect the financial system. The risk of conflicts of interests is inherent to the approach opted for by the Consortium partners. While the conditions and restrictions to be met by the Consortium regarding the steering of the ABN AMRO Group aim to remove this risk, nonetheless a residual risk remains.

In the final phase, Fortis and business units of ABN AMRO Group will combine to form an institution which – in the event that it runs into acute (solvency) problems – will expose the Dutch financial system and the real economy to greater negative spillovers than in the original situation. The concentration of these risks with a single party once more underscores the importance of continued safeguarding of the solidity of this new systemically relevant undertaking.

The tense situation on the international financial markets calls for vigilance, also as regards the intended takeover. The operational risks in the transition phase can be largely overcome with conditions and restrictions. Since conflicts of interest between the Consortium partners or with business units of ABN AMRO Group cannot be fully taken away by these conditions and restrictions, there is a residual risk. The financial stability risks entailed by the intended take-over and split-up seen in isolation, however, present no ground for a negative opinion. For further details, we refer to the Annex to this letter.

In view of the risks in the transition phase and the control thereof, DNB is compelled to monitor the envisaged disintegration of ABN AMRO Group closely, within the scope of both its regular supervisory activities and subsequent applications by the Consortium partners for declarations of no objection.

With kind regards,
ANNEX

This Annex starts by briefly explaining the terms financial stability and systemic risk and how they apply to ABN AMRO Group (hereinafter: ABN Amro) and then proceeds to interpret the present situation on the financial market. This is followed by a discussion of the main risks entailed by the split-up by the Consortium and the merging of ABN Amro’s Dutch retail branch with Fortis. The risks identified in this Annex are complementary to those identified in the prudential test performed within the scope of the application for a declaration of no objection, and primarily relate to contagion to the rest of the financial system and the real economy.

An analytical framework

Financial stability refers to a situation in which the financial system is capable of allocating liquidity so efficiently and absorbing shocks so adequately that they have no distorting effect on the real economy or on other financial systems. Close related to financial stability is systemic risk. This is the possibility of developments occurring that may seriously impede the functioning of the financial system and eventually cause severe damage to the real economy. Systemic risk becomes manifest once problems spread to other institutions as a result of contagion, but also if a number of institutions are simultaneously hit by the same shock. Systemic relevance refers to the measure of the potential systemic risk inherent to a segment of the financial system.

Application to ABN Amro

The systemic relevance of ABN Amro for the Netherlands in the original situation can be illustrated on the basis of the following three factors:

- Potential contagion channels to the rest of the financial system. In this regard, reference can be made to ABN Amro’s strong interrelatedness with other banks through the interbank money market and because of several important cross-participations. Also, ABN Amro is, as a major player, linked to the main payments and securities systems, it is the largest correspondent bank of the Netherlands and an important counterparty on the financial markets. Another contagion channel – in the (unlikely) event that ABN AMRO should go

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2 See DNB’s Quarterly Bulletin of December 2000, p. 6. Although various definitions of financial stability circulate, there is by and large consensus about this term.

3 About 5% of ABN Amro’s share capital was (in any case until quite recently) held by ING and Fortis.
bankrupt – is the Dutch deposit guarantee system, which provides that part of the losses are attributed to the rest of the banking system.

- Potential contagion channels to the real economy. Risks may manifest themselves by way of negative wealth effects, including deposits which in case of a bankruptcy are not protected by the deposit guarantee scheme. In addition, the real economy may be hit by a failure of the new undertaking’s financial services. Finally, unfavourable developments at ABN Amro may indirectly affect the real economy by undermining the confidence in the financial system.

- Shock resistance. This is the capacity to accommodate less-than-expected developments of various natures in an orderly manner, so that the consequences need not be transferred to other segments of the financial system or the real economy. Within this context, reference can be made to the sound solvency position of ABN AMRO Group, as well as the strong diversification across other market segments and geographic regions.

The systemic relevance of ABN Amro in the original situation implies that major changes regarding this undertaking may have substantial consequences for the financial stability in the Netherlands.

Before discussing our investigation, we refer to the current situation on the international financial markets. Signs increasingly point to a serious disruption of today’s global financial system currently, because internationally operating banks have substantially increased liquidity needs and therefore hoard liquidity. As a consequence, the international money market for maturities from one week and upwards is not functioning well at the moment. Banks’ uncertainty about their future liquidity needs arises from the deteriorated market climate for credit products. As a result, banks feel increasingly compelled to fund special funding vehicles related to them (‘conduits’) themselves again. The liquidity need potentially ensuing from this development is vast. The deficient functioning of the money market may have negative effects for all banks directly or otherwise involved in the envisaged acquisition. Therefore, there is a risk that the takeover process will become disorderly, which would harm the financial stability in the Netherlands.

We also note that the intended split-up of ABN AMRO Group, given its unique nature and complexity, calls for great care and enough time from the acquiring parties. At the same time, it is in the interest of the financial stability in the Netherlands that the duration of the period of uncertainty about the future of ABN AMRO Group is kept to a minimum.

The analysis below discusses a number of potential risks in the transition phase, the period during the split-up and integration processes, and the final phase, when the integration will have been completed.

Transition phase: implications of split-up and integration of ABN Amro by the Consortium

The disintegration of an internationally active major bank like ABN Amro and the subsequent division of the business units across the three Consortium partners will be a complicated operation without precedent. The parties have announced that this process is estimated to last two to three years. During the transition phase, the undertaking will be directed by a common structure, while also service platforms will be shared.

Due to its duration and complexity, the transition phase will be characterised by extra operational risks. Within this scope the following aspects are particularly important:

- As long as the payments operations of the new combinations (Consortium + ABN Amro) are run separately from the respective existing administrative systems, the transition phase will have no consequences for payments. This changes once ABN Amro’s administrative systems will be disintegrated and integrated with the Consortium partners’ systems. This consolidation process may take several years. It should be expected that, in anticipation of the full integration of the systems, the new combination will be striving to minimise the intraday liquidity costs. If it seeks to do so by rushing into consolidating the liquidity management and channelling the corresponding payment flows around the systems, significant risks may arise, especially in stress situations.
Furthermore, dismantling of ABN Amro’s Transaction Banking system will be a complex and time-consuming operation. Much time is expected to go into realising a division according to the lines along which the Consortium intends to split up the Group and its customer base. A hasty split-up may lead to extra operational risks, whereas a careful transition plan might mitigate such risks to a considerable extent. A plan to be approved by DNB should therefore be among the conditions and restrictions to be attached to the declaration of no objection applied for by the Consortium partners. A specific point of attention for the Consortium partners is the circumstance that during the transition period it will be difficult to realise synergy gains from their systems, both as regards the servicing of customers and the reduction of operational costs.

Special attention will be required for the critical payments, in particular those run through the various Real Time Gross Settlement (RTGS) systems of central banks and Continuous Linked Settlement (CLS), which handles the FX transactions. Too brash an integration may yield risks for liquidity management, in particular during emergency situations. In view of this aspect, too, a transition plan to be approved by DNB should be a condition. This plan should ensure that the integration of processes and procedures for liquidity management will not take place before the (supporting) administrative systems have been integrated.

Besides the disintegration of ABN Amro, the integration of specific business units with Fortis into a new undertaking is of relevance to the Netherlands. The integration process will probably not be completed when ABN Amro has been dismantled. The consolidation process may carry extra risks related to the migration of staff, systems and customers. The consolidation of administrative systems linked to payments will therefore continue to be an important point of attention in this phase.

Although these risks may be largely contained, the possibility cannot be precluded that in the transition phase conflicts of interests emerge between the Consortium partners or between individual business units of ABN Amro and one or several new owners. In such a case, the interests of ABN AMRO Group may be impaired and the care required for the disintegration process is liable to be pushed aside, which could adversely affect the financial system. The risk of conflicts of interests is inherent to the approach opted for by the Consortium partners. While the conditions and restrictions to be met by the Consortium regarding the governance of the ABN AMRO Group aim to remove this risk, a residual risk remains all the same.

**Final phase: implications of ABN Amro’s Dutch retail branch merging with Fortis**

The situation after the ABN Amro’s foreign business units and wholesale activities have been hived off and after completion of the integration of its domestic retail operations with Fortis, may be summarized as follows:

- Compared to the original ABN Amro, the new undertaking will lack geographic diversification advantages (as a result of foreign business units being hived off), which is partly compensated for, however, by the addition of the insurance activities of Fortis. On balance, the Dutch financial system as a whole will become less diversified. This implies a certain loss of shock resistance, since geographic diversification advantages will disappear without this being offset by extra sectoral diversification.

- Furthermore, combining the Dutch retail activities of Fortis and ABN Amro will result in a concentration of a number of risks with one party. This applies to the deposit guarantee scheme, among others. If this scheme is called on for the new combination, higher costs would have to be borne by a smaller group of banks. A similar concentration will occur in the provision of financial services. In the event of a failure of the new combination, the negative real-economy effects will probably be more serious than in the original situation. The fact that these risks will be concentrated with one party, once more underscores the importance of continued safeguarding of the solidity of this new systemically relevant undertaking.

This new combination will call for intensive cooperation with the Belgian authorities as regards the regular supervision, payments and crisis management. The existing forms of cooperation may serve as a basis for this, however. Furthermore, any measures of the new undertaking which may have consequences for special credit measures (ELA), burden sharing or the scope of the deposit guarantee scheme will need to be submitted for approval to DNB.