

Summary

Introduction

The Financial Supervision Office (BFT = *Bureau Financieel Toezicht*) is responsible for the financial supervision of about 1450 civil law notaries, 2000 junior civil law notaries, 380 court bailiffs and 410 junior court bailiffs, and also for monitoring compliance on the part of civil law notaries, lawyers, tax consultants and administration offices with the Money Laundering and Terrorist Financing (Prevention) Act (WWFT = *Wet ter voorkoming van witwassen en financieren van terrorisme*). In the framework of the WWFT the BFT monitors over 30,000 offices with 50,000-60,000 professionals. Supervision is carried out by two separate divisions within the BFT: a Financial Supervision division and a WWFT division.

At the request of the Research and Documentation Centre, Arena Consulting and Pro Facto conducted a joint investigation into the effectiveness and efficiency of the supervision carried out by the BFT.

Overall research plan

This study was conducted as an *administrative evaluation* of the BFT's supervision strategy. It focused on the effectiveness and efficiency of the *management philosophy* associated with financial supervision and monitoring compliance with the WWFT. To assess the effectiveness and efficiency of the BFT the researchers used an analysis model which had been prepared in advance. The most important features of this model are an effectiveness scale which distinguishes several levels of target achievement, and an explanatory model for effectiveness based on contingency theory.

The research work was done and the reports written between December 2008 and April 2009. The sources examined included reports, plans and correspondence concerning the development of the BFT and the execution of its tasks, and also figures relating to planning and work carried by the BFT. Appendix 1 contains a full list of the sources. These sources were primarily used to reconstruct the BFT's assumptions about its own organizational structure and working procedures and their operation in practice. A limited descriptive statistical analysis was conducted on the basis of quantitative data provided by the BFT. While we had intended to make a quantitative assessment of the BFT's effectiveness, it proved impossible to do so on the basis of these data. Seventeen interviews were conducted with the management and senior staff of the BFT and a representative cross-section of other employees, and with a number of civil servants employed by the ministries involved (Justice and Finance). We also used reports of some of the interviews conducted by the evaluation committee (with the consent of those interviewed).

Findings regarding financial supervision

The Financial Supervision division distinguishes three levels of supervision: *standard supervision* (every individual subject to supervision is investigated once every five years), *observant supervision* (the frequency is raised; in practice, this is applied mainly to recently appointed civil law notaries) and *heightened supervision* (an investigation is carried out on the premises of the party in question at least once a year and special arrangements are made concerning the frequency of reports). A risk analysis is made annually on the basis of the key financial data of *all* individuals subject to supervision.

The Financial Supervision division has a sound understanding of trends relating to risks and violations of standards among the individuals subject to supervision as a whole population, so that in principle the BFT is able to set the right priorities regarding supervision. An individual subject to supervision who is guilty of malversation has a considerable chance of being caught. By and large BFT is able to rectify violations of standards. The exception is situations which require formal repressive action. In these situations the BFT lacks the range of sanctions it needs and penalization through disciplinary law is not always appropriate. We were unable to establish whether the BFT is sufficiently successful in preventing recidivism, because the information required was unavailable. Financial supervision also has a broader preventive effect. One indication of this is that serious abuse of clients' accounts is very rare. The main basis for this is the relatively frequent contact between the BFT and the professional practitioners, and the resulting availability of information.

As regards the efficiency of the BFT's financial supervision there are two points which are questionable. The first is the number of investigations. Annually about 250 offices (of which 85% are civil law notaries and 15% court bailiffs) are investigated. The number of reports leading to complaints is less than 10%. The added value of regular investigation of professional practitioners with solid records of good conduct has not been demonstrated.

Secondly, it is debatable whether the Office's supervision strategy has kept pace sufficiently with developments in the notarial profession, in particular with two significant trends: a) greater free market operation and b) the introduction of clients' accounts. These developments call for a recalibration of the 'economic care and attention' traditionally offered to the notarial profession by the BFT. Greater free market operation requires a regulatory body which plays a supervisory role – at a distance – rather than an advisory role.

Within the given circumstances, the BFT is able to perform its task of financial supervision effectively. However, the BFT could work even more effectively if it had a wider range of powers – sanctions outside disciplinary law – and greater differentiation in the frequency

and depth of its investigations. This would lead to further optimization of a system which is at present fundamentally effective.

Findings regarding supervision of compliance with the WWFT

Supervision of compliance with the WWFT is still at the pioneering stage. In principle the supervision strategy is based on three approaches: a) raising awareness among the professional groups, b) promoting self-regulation and c) supervision. Supervision is carried out on a case-by-case basis and in practice the emphasis is on investigations in the notarial profession. Because of the large number of parties subject to supervision in proportion to the available supervisory capacity, actual monitoring is limited to a fraction (less than 0.5%) of the whole population. The focus is on civil law notary offices where the BFT thinks the number of violations of standards may be high or that the impact of these violations will be the greatest.

This division has a limited systematic overview of the risks and conduct of the groups subject to supervision as a whole. Because supervision of compliance with the WWFT concentrates on civil law notaries, this applies to a lesser degree to this professional group. On the basis of the available information, it seems the BFT's ability to select offices for special investigation – in connection with high risk – is reasonable to high. For the other professional groups subject to supervision, essentially the BFT has only a rough qualitative risk analysis. It is impossible to make a risk assessment at the level of specific offices or professional practitioners on the basis of systematic information.

Only a partial answer can be given to the question whether the BFT is capable of rectifying violations of standards. With its investigations, the Office at least succeeds in stimulating the parties subject to supervision to report any unusual transactions. By providing information and advice, the BFT has made a positive contribution to the improvement of compliance in general, particularly in regard to civil law notaries reporting unusual transactions. It does not seem likely that the BFT's supervision strategy has a preventive impact on the conduct of the entire group subject to supervision.

A few problems were observed with respect to WWFT supervision. The first has to do with the availability of information, in relation to both understanding of the professional groups as a whole and to carrying out investigations. A second problem is the imbalance between the number of parties subject to supervision (50,000-60,000 professional practitioners) and capacity at the BFT. Within the given situation (a very large group, which is diverse and partly inaccessible) the Office gives priority to civil law notaries with the highest risk. Although this prioritization is certainly defensible, two important points are debatable. The first is the scope of each investigation. It seems possible that with its current approach the BFT is going further than its strict remit as set out in the WWFT. With the active and intensive support of the Disciplinary Boards, the BFT is in danger of falling on its own

sword: the more successful it proves to be in its investigations, the more pressure will be put on the BFT's capacity for assistance and the more difficult it will become for the Office to carry out its primary supervisory tasks. A fundamental question is involved here: should a body in charge of supervision be actively involved in repressive action (disciplinary proceedings)? The borderline between supervision and detection becomes blurred. A final problem is the limited range of sanctions available to the regulatory body.

As far as monitoring compliance with the WWFT is concerned, the BFT cannot perform its task effectively in the given circumstances. At the system level, the costs and benefits of the WWFT supervision are disproportionate and do not offer any perspective for the future. Apart from the points for consideration mentioned with respect to the BFT itself, the causes lie mainly in the legislation (powers relating to information and sanctions), the specific properties of the groups subject to supervision (numerous, diversified and closed), the information set-up in the supervision and enforcement chain associated with money laundering (availability of residual information, data linking etc.), organizational factors affecting some parties in this chain (such as capacity of the Disciplinary Board) and the lack of a clear frame of reference to develop more systematic supervision.

Closer analysis

In addition to its concrete findings on the BFT's supervision, this study also raises a number of more fundamental questions about the supervisory system within which the BFT operates.

The first question regards the *boundaries* of supervision of social and economic activities: what can and should we supervise, what do we want to supervise? The difficulties involved in monitoring compliance with the WWFT are not unique – other supervisory domains are confronted with the same problems – and will continue to exist without reconsideration of whether or not the government should actively monitor all individual members of a population. From a practical perspective, in the case of monitoring compliance with the WWFT this is *impossible*; it would require too much capacity. However, in terms of effectiveness and efficiency it is also *unnecessary*.

The second fundamental question is what the policy focus of supervision should actually be. In terms of effectiveness a supervision strategy should be consistent with the behaviour patterns of the groups involved. Four basic types of compliance behaviour can be distinguished: a) willingness to comply, b) 'let's try it on' behaviour, c) calculating behaviour and d) criminal behaviour. Consistency means that there should be a clear structure accommodating the focus and role distribution of self-regulation (through professional groups), independent supervision at a distance, and detection and prosecution which correspond to these behavioural profiles.

The third fundamental question is what *kind of regulatory body* the BFT should be within this structure. Basically one of the following alternatives, which are to some extent mutually exclusive, could be chosen:

5. *Primary regulatory body* with an autonomous programme and the power to impose sanctions
6. *Auditor or regulatory assistant* which conducts investigations at the request of Disciplinary Boards or the Disciplinary Court and assists the Public Prosecution Office as an expert.
7. *Secondary regulatory body* which ensures that the system of self-regulation through audits, monitoring and disciplinary action operates adequately.
8. *A system monitor* which ensures that at the system level there is understanding of the risks and behaviours associated with independent professional groups.

A fourth and last fundamental question is whether *further integration of supervision of financial risks and integrity* is desirable. From an administrative point of view the differences between financial supervision and monitoring compliance with the WWFT are of degree rather than essential. Nevertheless, the parties subject to supervision have to deal with the different profiles of the same regulatory body. The main reason for this is that the supervisory strategies are at different stages of development. Moreover, the role distribution of supervision between the BFT, the AFM (Netherlands Authority for the Financial Markets) and DNB (De Nederlandsche Bank N.V.) is mainly a result of historical factors. Apart from the risk of different executions of the same statutory tasks, another problem is that the dividing line between professional groups is to a certain extent arbitrary and is by no means always clear.

From case-effectiveness to policy-effectiveness

To recapitulate, our conclusion is that what is needed is a change in supervision strategy *from case-effectiveness to policy-effectiveness*, particularly in relation to WWFT compliance, but also regarding financial supervision, not only in view of the current situation, but specifically with an eye to the longer term. This is not only or specifically a point which the BTF needs to consider; it is relevant to the role and position of government regulatory bodies in society in general, with respect to their legitimacy, the results of their work and their organizability.