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Pressure and Politics in Financial Accounting Regulation

-the case of the financial conglomerates in the Netherlands-

*Laurence A.G.M. van Lent**

Abstract

This study examines the political process of promulgating the draft laws 22169 and 22896, which pertained to the reporting of financial conglomerates, the lobbying efforts observed during the process, and the interaction between the government, the supervisors of banks and insurance companies, the industry and its associations, and the users and auditors of annual reports of bancassurance firms. Pluralism is used to derive predictions on the regulation process. These predictions are then tested and compared with hypotheses which are comparable in terms of explanatory power and which were based on elite theory, neo-corporatism and Marxism. Pluralism seemed to provide fairly accurate predictions, in this particular case.

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1. Introduction

On January 1, 1990, the general separation between banks and insurance firms in the Netherlands was abolished. This separation had been based on the 'structure policy' of the Dutch Central Bank '*De Nederlandsche Bank*' (hereafter, DNB) (DNB, 1989: 111). Subsequently, a merger and co-operation movement was set in motion, which resulted in the establishment of a number of financial conglomerates, otherwise known as mixed financial companies. These included the co-operation between AMEV, VSB and the Belgian AG under the name Fortis, the expansion of the participation of RABO in Interpolis, and, finally, the merger of Nationale Nederlanden and NMB Postbankgroep, now known as ING (DNB, 1990: 124).

Running parallel to this development was the implementation of the EC directive regarding annual reports of banks and other financial institutions.¹ The stipulations of this directive are incorporated in section 14 of title 9 book 2 of the Dutch Civil Code. Title 9 of the Civil Code is integrally applicable to banks unless it is explicitly stipulated otherwise in section 14. Furthermore, the EC directive regarding annual reports of insurance companies was laid down on December 19, 1991. The incorporation of this directive in section 15 of title 9 book 2 Civil Code was established by publication in the *Staatsblad* (Statute Book) on October 14, 1993 (Staatsblad, 1993, no. 517). The establishment of mixed financial companies was not anticipated when the EC directives were drafted. Therefore, there were no references in the directives to the annual reports of these conglomerates. The national legislature now had the opportunity to stipulate reporting requirements for financial companies which engage in banking as well as insurance services. The lacunae in European law made it possible to conduct research in the Netherlands regarding the legislative process, without European influences obfuscating the issue.

It should be noted that reporting requirements for banks and insurance companies differ. Mixed financial companies, however, are not subjected to the legislation of banks nor to the legislation of insurance companies. The following questions can be raised concerning the reports issued by these companies:

- Should both activities be consolidated into one annual report?
- When the activities are consolidated, what method of valuation should be used?
- How should the balance sheet and income statement be presented?
- What separate information on the segments should be given?²

Moreover, a special property of banks and insurance companies should be noted; they are supervised by De Nederlandsche Bank (DNB) and the '*Verzekeringkamer*' (Insurance Chamber), respectively.

At the moment, it is not clear whether all the parties involved will answer these questions identically. It could be expected that if the interests are large enough, parties will try to influence the legislature in order to get their views reflected in the reporting requirements. An interesting question is whether economic theory can predict what will, in the end (equilibrium), be the result of the actions of the parties involved. These

¹ This directive should have been incorporated in national law before December 31, 1990. However, the bill containing the requirements of this directive was published in the *Staatsblad* on May 27, 1993 (Staatsblad, 1993, no. 258).

² The four questions are taken from Van der Tas (1993: 189).

actions might be predicted using pluralist theory.³ The shortcomings of this theory are that no predictions or explanations are presented about the process leading to equilibrium. In order to establish a 'richer' theory, a process view appears to be necessary.

The goal of this paper is to test the predictions of pluralist theory in a special accounting setting, namely, the case of the regulation of financial reporting by financial conglomerates. Those predictions are then compared with other explanatory theories on the political process. In addition, an attempt is made to provide a fuller understanding of the political decision-making process. The actions of the parties involved which are aimed at influencing the political decision-maker are central to the description of this case. Increasing the understanding of the phenomenon 'influence attempts' is relevant to policy makers because it gives them the opportunity to react adequately to these actions. The parties involved, however, may be able to formulate a better strategy if they can increase their understanding of the regulation process. Section 2 of this paper contains an overview of theories on the political process. In section 3, the results of the research are presented and discussed. These results include a fuller description of the institutional framework, which was briefly introduced above. Section 4 contains an analysis of the results of the research obtained by comparing the data with the predictions which follow from the theories on the political process. Finally, some concluding remarks are made in Section 5.

2. *Theories on the political process*

Scholars of the political process in the modern capitalist state have come up with four possible explanations of, or views on, the role of the state, which have been incorporated into the pluralist, elite, Marxist and (neo-)corporatist theories respectively (Ham and Hill, 1988). The pluralist views have pervaded accounting theory, especially in the writings of the Rochester school (e.g., Watts and Zimmerman, 1978, 1979; Holthausen and Leftwich, 1981; Zmijewski and Hagerman, 1981 and Kelly, 1983). Marxist thought has been given attention by Tinker (1984), although he calls it a radical approach. Few studies in accounting use an alternative explanatory framework. Recent work by Walker and Robinson (1994), for example, rejects corporatism as an applicable model as it may not adequately describe the dynamics of regulatory process on particular issues. Walker and Robinson employ a model of organisational conflict, as developed by Baysinger (1984). Such a theory of organisational conflict, however, is not as much a theory on the role of the state, or the political process, as it is a recognition of the non-monolithic character of the state, in that it recognizes that governmental institutions can have conflicting interests. Also, elite theory does not seem to have received much attention by accounting scholars. The four models will be briefly outlined and each theory will be compared to pluralism which is the central theoretical framework in this study.

Pluralism holds that the sources of power are unequally though widely distributed among individuals and groups within society. The sources of power are distributed non-cumulatively and no one source is dominant. 'Essentially, then, in a pluralist political system power is fragmented and diffused and the basic picture presented by pluralists is of a political marketplace in which leaders compete for votes ...' (Ham and Hill, 1988: 28). Consequently, government is seen as an interest group itself, among other interest groups. The

³ Pluralist theory underlies Watts and Zimmerman's studies (1978, 1979). It is presented in Sutton (1984) and Lindahl (1987). A recent empirical study using pluralism is provided by Rahman, Ng and Tower (1994).

outcome of the political process (equilibrium) depends on the relative strength of the interest groups involved (Becker, 1983; Hirschleifer, 1976). Regulations are demanded and supplied (by government) in order to fulfil the self-interest of the actors in the process (Peltzman, 1976; Tollison, 1982; McCormick and Tollison, 1981; Watts and Zimmerman, 1978).⁴ Limiting the analysis to accounting-standard setting, such standards are seen as products of a process in which regulations are set on the strength of the demands of effectively participating interest groups and to fulfil the needs of the suppliers, i.e., the standard setters (Rahman, Ng and Tower, 1994). The entrance of an issue in the political process is the result of a perceived crisis (Watts, 1978). Nobes (1991) implies that a wave of take-overs can provide the energy to start a regulatory process.

Elite theory argues that political power is concentrated in the hands of a minority of the population. The existence of such a political elite is a necessary and indeed inevitable feature of all societies (Mosca, 1939). In the modern state, the position of elites is related to large-scale organisations in many areas of life, resulting in different kinds of elites. The sources of elite power are many, e.g., occupation of formal office, wealth, knowledge; these sources may to a certain extent be cumulative but power does not stem solely from one source. The coupling of power and the membership in certain organisations, leads to an institutional view on the political process. Indeed, organisational control and institutional position are seen as key political resources (cf. Mills, 1956). Bachrach and Baratz (1970) drew attention to the use of political power to confine discussion to safe issues, in other words to control the political agenda. Elite theory does not seem to have attracted many accounting scholars, although the notion of non-decisionmaking has been used in several studies of standard-setting bodies (e.g., Hussein and Ketz, 1991; Booth and Cocks, 1990). In the case at hand, elite theory can prove to be valuable as the Netherlands is sometimes described as a highly institutionalised country. Furthermore, since the country is small, one may expect to encounter the same people in high positions in these institutions, a ruling elite. Indeed, research seems to confirm this position (Driehuis, 1989; Van der Knoop, 1991; Donkers en Stokman, 1984).

In conclusion, the main difference between pluralism and elite theory seems to lie in the aspect of concentration and accumulation of power.

Marxism considers the state not as a neutral agent, but as an instrument for class domination. The state's main function is to assist the process of capital accumulation, by creating conditions in which capitalists are able to promote the production of profit. Central in the discussion is the relation between political and economic power. Capitalism, as a system of social relations, is characterised by inequalities consisting of restriction of the access to and use of property, and the dependence of some social members on the marketplace to provide them with the means of subsistence through the realisation of their labour (Ham and Hill, 1988; Tinker, 1984).

Whereas the pluralist position asserts that economic power is a factor in influencing the political process, Marxism argues that the sources of economic (and therefore political) power are not diffused, but concentrated. The structure of the distribution of the political and economic power reflects the inequalities imposed by the social relations of capitalism. Whereas Watts and Zimmerman (1978) see the accounting practice as an outcome of economic events (viz., the solution of a principle-agent problem) Marxism considers the accounting practice as a reflection of the wealth distribution which is the result of the political process and

⁴ It should be noted, however, that the self-interest concept is not falsifiable and, therefore, by explaining all behaviour it explains none (Sterling, 1990).

consequently, of the inequalities in social relations (cf. McCormick and Tollison, 1981).

(Neo-)corporatism argues that the governmental system incorporates major interest groups into the regulatory process. The effect of incorporation is to maintain harmony and avoid conflict by allowing these groups to share power (Middlemas, 1979). Schmitter (1974) sees the development of corporatism as a result of the need to secure conditions of capital accumulation. Capital accumulation is threatened by concentration of ownership and competition between national economies (cf. Ham and Hill, 1988), therefore the state is forced to intervene more directly and bargain with political associations. Corporatism emerges because the state requires the professional expertise that can only be provided by singular hierarchically-ordered and consensually-led representative monopolies. Such monopolies use their privileged position to achieve their own interest. Once incorporated in the political process, interest groups become an important instrument in implementing agreed-upon policies. Thus, interest groups not only present their members' view before decisions are reached, but more importantly, they secure compliance from their members in the implementation stage of the process. The Netherlands have been characterised as a corporatist society (Hague, Harrop and Breslin, 1993).

It is relevant to note that as pluralism emphasises an upward flow of preference from group members to their leaders, corporatism stresses the downward flow of influence. Moreover, corporatism is an attempt by the state to develop a coordinated approach, whereas coordination is absent in pluralism; in pluralism the outcome of the political process is the result of conflicting interests of different groups, not of an attempt to harmonise such interests.

In accounting, corporatism has been used to describe how the accounting profession has organised itself or sought to regulate accounting practice (Walker and Robinson, 1994; Walker, 1987; Willmott, 1986).

An important point to note is that pluralist theories rely heavily on the notion of economic Darwinism, that is that those institutions, regulations and indeed, accounting methods survive in equilibrium which are the (cost-)efficient (Watts and Zimmerman, 1990). Elite theory, Marxism and corporatism are more theories of strategic behaviour, of power. Such theories analyse behaviour in terms of appliance of power. Tabel 2.1 provides an overview of all four theories.

Regulation implies that certain economic agents are restricted in their implementation of ex ante plans, therefore, regulation results in wealth transfers (McCormick and Tollison, 1981).⁵ This is also true of the regulation of financial reporting. Choosing between two frameworks of reporting requirements, is similar to the choice between two wealth distributions (May and Sundem, 1976; Bryant and Thornton, 1983). Since economic agents are affected in their wealth by regulation, they have an interest in the regulatory process. All economic agents are potential wealth suppliers as well as demanders. The role of the government is to grant favours to groups in society, thereby increasing its own control over resources. As noted above, pluralism contends that all agents act in self-interest, including government agents. The self-interest of government agents consists of remaining in office (politicians) and thus securing sufficient votes for this purpose or increasing the size of the agency in which they are employed (civil servants) and thus securing sufficient funds. Attempts by economic agents to induce the government to grant favours are not without costs. Information costs occur because agents have to translate proposed legislation into the consequences

⁵ Except for Pareto-optimal regulation.

such legislation will have for their wealth. Information costs also occur because the position of other agents has to be identified in order to find potential supporters, so that an estimate of the possibility of a successful influence attempt can be made (Tollison, 1982). If economic agents consider the costs of lobbying individually too high, they may combine their interests and undertake collective action. In that case, organisation costs will be incurred, including the costs of monitoring the free-riding behaviour of individual members of the group (Sutton, 1984; Lindahl, 1987; Watts and Zimmerman, 1986; Peltzman, 1976). Finally, the costs of using a certain lobby method must be considered (Van Schendelen, 1988; Berry, 1977) In pluralist theory, lobbying or striving for governmental favours is, in the end, a cost/benefit trade-off.

A relevant question is whether it is possible to predict which economic agents will participate in the political process. It has been stated that owing to the lobbying costs, only agents with substantial expected benefits will try to secure favours. 'For the preparer of financial statements, the potential benefits of securing his favored proposal ... are likely to be greater in absolute terms than the benefits to the user obtaining his.' (Sutton, 1984, p. 85). The stronger propensity of preparers to lobby can be attributed to the fact that, in general, preparers are wealthier than users. Furthermore, preparers are likely to draw income from limited sources. Threats to one of these sources, have a greater adverse effect on the income position of preparers than of users who are usually able to diversify their income portfolio (Sutton, 1984, p. 85). Consequently, lobby efforts are said to be dependent on the resources at an agent's disposal (Becker, 1983; Blake, 1973). One should remember that pluralism contends that resources are widely but unequally distributed, and therefore lobbying will be undertaken only by certain groups. Moreover, as regulation is a public good, no agent being excluded from its benefits after implementation, no incentive will exist to contribute to the costs of lobbying. Unless a cost-sharing rule is agreed upon, lobbying will only be undertaken by those agents whose expected total benefits exceed their lobbying costs. It seems reasonable to assume that a large agent's probability of receiving sufficiently high benefits is higher than a small agent's. Thus, large agents are expected to lobby. This is in accordance with Olson's (1965, p. 29) observation that 'there is a systematic tendency for exploitation of the great by the small.' Cost-sharing rules, and other measures for facilitating effective collective action, combined with start-up costs which are incurred when initiating an organisation which unifies agents with similar interests, leads to the observation that existing organisations are more likely to undertake lobbying than ad hoc groups. Industry associations are likely candidates to represent the views of preparers of financial statements. However, since members of a lobby organisation do not necessarily share identical opinions on all issues or are not involved in all issues, one may expect some members to trade their support for an issue against reciprocal support of an issue which does involve a member. Thus, when intensities of preferences over a certain matter, differ between members of a lobbying group, logrolling may occur, i.e., the agent who feels the strongest preference on an issue will be supported by other agents (with marginal interests) on the condition that such support is reciprocated in due time.

With regard to the process of political decision-making, the methods and instruments that are used by economic agents, to put their views on the stage and thereby gain influence over the process, must be considered.⁶ In general, the position of lobbying agents depends on the extent to which their views are integrated in society (Van Mierlo, 1989). If a certain view is part of the common opinion, softer lobbying methods will be applied. Sutton (1984) argues that the choice of method depends on the cost-effectiveness of

⁶ Van Schendelen (1988) provides a fairly complete overview of lobby methods.

each instrument. Although it is indeed important to note that every instrument involves an investment of resources and that instruments may differ in terms of resource consumption, effectiveness, and efficiency, one should not neglect such aspects as culture, historical background, size, the relative importance of the issue at hand as well as the expertise of a group of agents, as factors explaining a particular choice (Berry, 1977). Many of the methods applied, seem to consist of some form of information transfer from the agent to the government. Indeed, subsidizing information that supports the position of an agent is generally considered an important instrument (Watts and Zimmerman, 1979; Bartlett, 1973; Van Schendelen, 1988). Sources of such favourable information are found in auditors' technical departments, in academic research and in-company. Watts and Zimmerman (1979) argue that accounting theories are merely provided by academics to support certain views in the political process. Although such theories frequently refer to the public interest, they are, in fact, construed to increase the possibility of acceptance of a favoured proposal by the legislator. Bartlett (1973: 133) provides a similar argument 'much of the pressure placed upon the government ... takes the form of freely provided 'objective' studies showing the important outcomes expected from the enactment of particular policies.'

Another way of transferring one's view, is simply to participate in the exchange of views when a new regulation is being discussed. An official⁷ of the Federation of Dutch Industries (VNO) stated that lobbying the political process is most successful when initiated in the early stages of the process, indeed, lobby attempts should be started even before a proposal or draft has been written. The same official also argued that private conversations and informal meetings with members of parliament, and government (politicians as well as civil servants) are the most effective lobbying instruments. This opinion has been supported in literature (Sutton, 1984; Van Schendelen, 1988).

With regard to the timing of lobbying, it seems to be critical to initiate attempts at influencing as early in the process as possible (Sutton, 1984; Lindahl, 1987). Once a certain regulation is enacted, the possibility of changing its implications is limited. However, as Amershi *et al.* (1982) correctly point out, lobbying is likely to be a multi-issue, multi-period process, especially for (professional) collective-action organisations such as industry associations or unions. Consequently, conducting research in one issue may present methodological problems in that the behaviour of certain lobbying agents can only be understood by taking a long-term view and considering multiple issues.

Before turning to the case description, the position of the players should be predicted. It seems reasonable to assume that users of financial statements prefer as much disclosure of information as possible as long as it is provided freely (Mian and Smith, 1990a). Since disclosed accounting information is a public good (Gonedes and Dopuch, 1974) additional disclosure will be free. The issue at hand is whether financial conglomerates should be allowed to consolidate both insurance and bank activities and if so, whether additional, segmented information on the separate activities is required. Consequently, users will prefer no consolidation or when consolidation is allowed, they will prefer additional segmented information. It should be noted that unconsolidated financial statements are generally more informative than consolidated financial statements in the sense that the information in a set of unconsolidated statements generally allows a user to perform a 'homemade' consolidation, particularly if the magnitude of the within-group contracting is reported or small; the reverse is, however, not true (Mian and Smith, 1990a).

Management has incentives to disclose information, for this may reduce agency costs (Jensen and Meckling,

⁷ Interview with M.W. Noordzij on July 8, 1994.

1976). In other words, monitoring management's behaviour through the publication of accounting reports, may reduce the costs associated with the divergence in interest between the manager and the holders of outside capital (Leftwich, Watts and Zimmerman, 1981), especially, if the manager can produce financial information at lower costs than the holders of outside equity can. Mian and Smith (1990a) hypothesised that the more dependent the parent-subsidary activities, the more likely the subsidiary operations will be reported on a consolidated basis. Three kinds of interdependencies, operating, information, and financial interdependencies, can be analyzed. It should be noted that accounting is a basic part of the organisational structure and that accounting practice and organisational form are related (Jensen, 1983). Therefore, the consolidation choice may be viewed as an organisational decision. The decision on organisational form can result in several structures, e.g., a specific activity can be retained within the firm by a department or division, otherwise it can be contracted to an independent firm. A structure between these extremes would be to have an activity performed by a subsidiary. Of course, other options are available. Extending Klein, Crawford and Alchian's (1978) analysis in which it is argued that the more firm-specific the activity, the more likely it is that it will be performed within a department or division and the less likely it is that it will be subcontracted to an independent firm, Mian and Smith (1990a) state that the more interdependent the parent and subsidiary activities, the more likely the subsidiary's performance will be reported on a consolidated basis: 'Thus we suggest that this accounting decision reflects the firm's choice of organizational structure and is determined by interdependence between the parent and the subsidiary activities.' (Mian and Smith, 1990a: 143). This interdependence hypothesis relies on the proposition that if one set of accounting numbers is reported internally it will also tend to be reported externally.

Mian and Smith's (1990a) research considers the consolidation of financial subsidiaries, e.g., the lease subsidiary of a car manufacturer. This paper studies the consolidation of two more or less equal firms, which were formerly independent, i.e., a bank and insurance company. Therefore, Mian and Smith's (1990a) elaboration of the role of interdependences is paraphrased. The theoretical ideas on organisational form and accounting are, however, maintained.

Operating interdependence extends to real production activities between parent and their subsidiaries. Operating interdependences appear to be significant in the financial conglomerates' case. For example, as will be shown, financial conglomerates repeatedly uttered the wish to be able to offer their clients a complete range of financial products. Furthermore, in this age of financial innovation, many financial products include insurance as well as credit attributes, and cannot, therefore, be characterised as bank or insurance products.

The information interdependence hypothesis implies that for that set of information over which managers exercise discretion, they must disclose any information for which the incremental benefits exceed the costs, in order to maximize firm value. This results in the prediction that the higher the potential information costs associated with the subsidiary's activities, the more likely those activities are to be reported on a consolidated basis. Such information costs consist of out-of-pocket costs of accounting procedures and the costs associated with proprietary information, i.e., information that reduces the present value of the firm's expected cash flows owing to the publication of information. One could argue that competitive pressures in the financial markets are high and that, therefore, all performance information will be scrutinized by competitors. Consequently, information costs could indeed be significant in this case.

Financial interdependence may take two forms, 'personal responsibility' and 'equity support'. If a parent takes personal responsibility for a subsidiary's debts, Dutch law does not require the subsidiary to structure and disclose its annual report according to the full requirements of title 9. This subsidiary's financial information should, however, be consolidated in the consolidated report of the parent. Thus, if personal

responsibility is taken by the parent for a subsidiary, the prediction is that such a subsidiary will be consolidated.

Banks as credit extending institutions have special obligations to their creditors. In particular a bank's shareholder equity and solvency are important in developing and maintaining trust in the abilities of a bank to observe its contractual obligations. Therefore, if certain subsidiaries receive equity support from the parent or other subsidiaries within a financial conglomerate, it may be expected that these subsidiaries will encounter problems in observing their obligations. In light of the importance of trust with regard to banks, it is often not advisable to report massive equity movements to the public. Equity movements are not visible in consolidated reports.

Consequently, the higher the interdependence (over all three dimensions), the more likely management will report on a consolidated basis.

One other group of players deserves some attention, i.e., the auditors of the companies involved. Various incentives regarding lobbying behavior for accounting firms have been identified in literature which are not mutually exclusive (Mian and Smith, 1990a). Watts and Zimmerman (1986) argue that accounting firms have incentives to lobby for standards (i.e., regulation) that increase their value; an increase in value can be expected if audit fees rise due to increased auditing services which originate in the examination of the consolidation of, previously, separately-reported activities. Consequently, auditors will favour increased consolidation. Furthermore, when separate statements on activities are to be provided in order to prevent information loss, additional auditing activities can be expected, and auditors can be expected to favour such separate statements, as well. However, auditors have an incentive to support the lobby of their clients (Haring 1979; Puro, 1984, 1985). Puro shows that in lobbying the FASB, accounting firms do not support their clients in disclosure matters, however, they are more supportive of their client's position on technical issues. Moreover, accounting firms are expected to be more concerned about the position of their large clients than of their small clients, if audit fees are positively related to firm size (Mian and Smith, 1990a). Watts and Zimmerman (1986) hypothesise that accounting regulation which restricts the available accounting procedures will be opposed by auditors. Management would like to have as much discretion in accounting choice as possible in order to maximize its wealth; restrictions on the acceptable set are, therefore, likely to be opposed (Watts and Zimmerman, 1990). Consequently, the interests of management and auditor do not conflict. Furthermore, they suggest that regulation which increases accounting complexity and thereby raises audit fees is supported by auditors. The latter hypothesis strengthens the conflict of interest with management. Since management will have an incentive to decrease audit fees it will oppose accounting regulation that raises complexity. As stated at the beginning of this paragraph, the incentives that auditors face are not mutually exclusive, but they may be in conflict. The result of this conflict depends on the relative strength of each incentive.

3. *The case: financial conglomerates in the Netherlands*

3.1 *The Dutch regulatory process*

To understand the political process in the development of the legislature pertaining to reporting by financial conglomerates, it is necessary to have some knowledge of Dutch regulatory processes. A useful characterisation of the Dutch regulation of financial reporting is provided by Zeff *et al.* (1992: 367). "Parliamentary companies legislation has prescribed certain financial reporting practices. Self-regulation stimulated by the government occurs in the private sector, but within a private-sector framework: statements embodying guidelines are issued, but without any monitoring by the government. Interested parties and the

Attorney-General (when in the public interest) may initiate a judicial proceeding in a special court to require companies to adhere to the statutory prescriptions; efforts to promote compliance with the private-sector guidelines are limited to confidential discussions with the auditors of companies that apparently are departing from guidelines." Using Puxty's *et al.* (1987) regulatory classification scheme, Zeff *et al.* (1992) feels that the Netherlands reflects the dual influence of Associationism and Legalism, while it is also tinged by a shade of Corporatism. Although it is clear that any classification has its limitations, Zeff's proposal, using three out of four categories to characterise the Dutch regulatory environment, is not satisfying. Given the resemblance between the Dutch and the English regulatory process and given Puxty's classification of England as Associationist, it would be best to classify the Netherlands as Associationist.

In addition, it can be stated that the guiding principle of the institutional framework of corporate financial reporting in the Netherlands consists of a system of 'frame legislation' in which, wittingly, only the main lines of corporate annual reporting have been regulated. The frame legislation on annual reporting is vested in company law. Company law in the European Community is subject to a policy of harmonisation. This is apparent in the fourth EC Directive pertaining to annual reports of companies. This directive stipulates requirements on structure, disclosure, and audit of the annual report. As of December 30, 1983 Dutch law has incorporated this fourth directive. Furthermore, the seventh EC Directive is of importance, this directive stipulates requirements for the consolidated annual report. Dutch company law was adjusted to the requirements of the seventh directive by the Act of November 13, 1988.

The legislative frame is laid down foremost in the terms of title 9 of book 2 of the Civil Code (*Burgerlijk Wetboek*) and title 11 of book 3 of the Code of Civil Procedure (*Wetboek van Burgerlijke Rechtsvordering*). Title 9 Book 2 contains requirements regarding the structure (*inrichting*), disclosure and audit of the balance sheet, the profit and loss statement, and the notes to these statements. It also contains requirements pertaining to the management discussion and analysis of the financial condition and results of operations (*jaarverslag*) and the other data (*overige gegevens*). Title 11 of Book 3 Code of Civil Procedure pertains to the judicial administration of title 9 Book 2 of the Civil Code.

As Zeff *et al.* (1992) stated, private sector regulation within a private sector framework does occur. The Council on Annual Reporting, in which various interest groups are represented, issues guidelines. The Council contains representatives of preparers (employers), users (employees/unions/financial analysts) and auditors. The guidelines of the Council elaborate on the stipulations of the frame legislation. The guidelines themselves, however, do not have the force of law.

Reviewing the institutions and processes of Dutch reporting regulation, the conclusion may be drawn that some knowledge of the general process of enacting laws in the Netherlands is necessary in order to understand reporting regulation. Owing to the similarity between the Dutch legislative process and many other democratic legislative processes, I will not dwell on a formal discription of the procedures. Rather, they will become clear in the chronological part of the case study. A brief introduction to the process, however, can be obtained in Zeff *et al.* (1992).

Zeff *et al.* (1992) states some special characteristics of financial reporting regulation in the Netherlands, including the irrelevance of tax laws, the absence of a securities commission, the absence of a 'standards' program and the observation that managers' bonuses based on profit are not a pervasive practice. Moreover, the comparability of annual reports is not a governing consideration in the regulation of Dutch financial reporting. Indeed, a different criterion is the guiding principle, i.e., the insight requirement. Financial

statements should furnish the insight required to enable the formation of a sound judgment as to the company's financial position and the result of operations, and, to the extent possible, into solvency and liquidity (Zeff *et al.* 1992: 27). This insight requirement plays an important role in the bancassurance case, as will be shown.

3.2 *Setting the scene: the general separation of banks and insurance companies comes to an end*

Until 1990, the Dutch Central Bank was committed to the structure policy (*structuurbeleid*), this policy was designed to facilitate sound banking practices and to enhance healthy competition in the industry. Part of this structure policy, was that a 'Statement of No Objection' had to be obtained by any bank which wanted to merge with another organisation or which wanted to participate in the capital of another organisation for more than 5%. In 1981, it was reaffirmed that entanglement of banks and insurance companies should be prevented. Furthermore, it was decided that both banks and insurance companies should be prevented from co-operating or merging with mortgage banks. Owing to problems with mortgage banks the restrictions on participating in mortgage institutions were abolished in 1982, in order to strengthen shareholder equity of the mortgage banks. According to Visser (1993) the problems with the mortgage banks provided a motive for abolishing the restrictions on the participation of insurance companies in banks. Moreover, the common market for financial services in the EC was about to be realised, and it was felt that in order to survive on this common market, Dutch financial institutions had to be fortified. In fact, the past decade is characterised by a general feeling that deregulation and liberalisation, i.e., letting the markets do the work, is the best policy. Van Roij (1992: 52) gives two reasons for this deregulation tendency. First, regulation was no longer proving effective, i.e., regulation was not achieving the aims it was meant to. In addition it had become possible, due to the liberalisation of international capital markets, to avoid national regulation. Another way of avoiding national law, was to adopt new organizational structures which were not subjected to the requirements of law. Second, the insight became pervasive that detailed regulation of financial activities was not efficient. Regulation can lead to rigid industry relations and decreased competitiveness. Regulation can also hinder innovation in an industry. On January 1, 1990, the abolishment of the general separation between banks and insurance companies took effect. In its annual report over 1989, DNB announced that the VSB bank and the AMEV insurance group intended to merge as soon as DNB lifted the prohibition on mutual participation of banks and insurance companies. A similar announcement was made regarding the intention of RABO to increase its participation in the insurance company Interpolis (DNB 1990, p. 130-131). In its 1990 annual report, more mergers were announced by DNB, the most important being the merger of Nationale Nederlanden and NMB Postbank Groep NV into the Internationale Nederlanden Groep NV (ING). Furthermore, a number of former union banks and insurance companies merged into Reaal Groep NV (DNB 1991, p. 124-125).⁸

⁸ Shleifer and Vishny (1994) provide additional evidence on the role of regulation in takeovers.

3.3 *A brief sketch of the problem: annual reporting by financial conglomerates*

A general requirement of title 9 book 2 of the Civil Code pertains to the obligation to consolidate the financial statements of all subsidiaries in a group and of all group members (article 406 paragraph 1). However, when consolidation of a group member violates the *insight requirement*, the (consolidated) annual report of such group member has to be included in the notes to the consolidated statement of the group. This type of violation of the insight requirement is caused by differences in activities between the group member and the group (art. 406 paragraph 3). In the literature pertaining to paragraph 3 of article 406, the case of banks and insurance companies as members of a group is explicitly mentioned as an example of a situation in which differences in activities may prevent consolidation (e.g., Burgert, Joosten and Timmermans, 1990:⁹ 596 and Proceedings Second Chamber, 19813 no 3)

The question at hand is, whether financial conglomerates should consolidate both banking and insurance activities. And furthermore, if consolidation is allowed, what should be done about the reduction in information concerning individual activities. This reduction can be compensated by providing segmented information in the balance sheet, the P&L or in the notes (see also, Van der Tas, 1993). Thus, if consolidation is allowed, one also has to decide which additional information on the segments is necessary. Although, one could doubt whether the consolidation of the banking part of a company primarily active in, for example, the steel industry leads to insight in the financial position of such a company, it is not apparent that consolidation of banks and insurance companies violates the insight requirement. The Minister of Justice and the industry association, the NVB¹⁰, insisted that violation of the insight requirement in case of financial conglomerates should not be assumed too readily. Indeed, they argued that owing to the growing innovation of financial products it will become more and more difficult (and even: useless) to distinguish between banking and insurance products. Therefore, consolidation of the banking and insurance activities in the annual report of the holding is not unquestionably in conflict with the insight requirement. The NVB puts it even more strongly: financial conglomerates have to and wish to present themselves as indivisible entities. Since no special rules as are given in chapter 14 and 15 of title 9 apply to financial conglomerates, these companies are simply subjected to the fourth and seventh EC Directive (Explanatory Memorandum 22169 no. 3, p. 19). Consolidation of the activities of a financial conglomerate would, therefore, be desirable.

3.4 *The legislative process part 1: the banking Directive incorporated*

In a previous section of this paper, it was stated, that Dutch financial reporting regulation reflected the fourth and seventh EC Directives. Article 1 paragraph 2 of the fourth Directive (PbEG L222 August 14, 1978) stipulates that members of the EC are not compelled to subject banks, other financial institutions, and insurance companies to the requirements of this Directive.¹¹ Notwithstanding this possibility in the EC Directive, banks and insurance companies were not excluded from its operating range when both directives were incorporated in Dutch companies law (i.e., title 9 book 2 Civil Code). However, some important

⁹ Burgert et al.'s example involved a bank or insurance company which was a member of a group whose main activity was in the field of steel or shipping.

¹⁰ NVB stands for Nederlandse Vereniging van Banken, *Dutch Association of Banks*.

¹¹ The exemption of banks and insurance companies from the fourth Directive was temporary, however, i.e., pending further coordination of these companies, the fourth Directive was not necessarily applicable to them.

exceptions were made for these firms, the foremost of these being on the degree of segmentation, the method of valuation of investments, securities and foreign currency, and the possibility of nondisclosure of the general banking risk reserve (articles 399 and 400 book 2 Civil Code).

On December 8, 1986 the Council of the European Community accepted the proposed Directive on annual reporting by banks (hereafter, the banking Directive) (PbEG L372, December 31, 1986). It is interesting to note that the DNB was the spokesman of the Dutch delegation at the EC's meetings regarding the banking Directive.¹² The DNB carried the point that consolidation of bank and insurance activities should not be allowed, which was also the general opinion in the EC. It should be noted that this issue was barely a point of discussion at the EC meetings pertaining to the banking Directive. This opinion resulted from the seventh EC Directive, in particular article 14, which deals with consolidation. Article 14 stipulates that activities outside the line of business should not be consolidated. This is particularly true when the activity is a bank or insurance company. More generally, the DNB held that it was appropriate to allow only a limited degree of freedom in reporting practice within a particular industry. General reporting requirements are relevant only when they apply to a broad category of firms. Consequently, the DNB stressed the comparability argument for reports of firms within an industry. Thus, in the EC discussion, the DNB agreed with the *communis opinio* that insurance and bank activities could not be consolidated. This opinion was illustrated by rhetorical questions such as, why would the EC issue a separate insurance and bank Directive if merger or consolidation of both were to be possible? Indeed, why would there be separate supervision of banks and insurance companies if these firms were to be able to merge?

In the EC meetings, the DNB additionally proposed including an optional paragraph in the Directive regarding the exemption of the consolidation of sub-groups. Such an exemption would be issued if the parent guaranteed the commitments of the exempted company. Furthermore, the parent had to be a credit institution. (art. 43 paragraph 2b PbEG L372) Although the DNB proposed this optional paragraph, the Dutch Justice Department chose not to use this option in its draft law.

Later in the process, when the banking Directive was transformed into a draft law by the Dutch Justice Department, the DNB lifted its objections to the consolidation issue. The opposition of DNB to the consolidation of bank and insurance activities was not sustainable as (economic) pressures rose. As a supervisory agency, the DNB had more important issues to consider than reporting requirements. To disturb the delicate balance of power between the DNB and the Dutch financial institutions on this minor point seemed futile.¹³ Also, there was some understanding within the central bank that these new financial institutions would wish to show their financial strength in its totality. However, since these institutions were likely to have important impact on the public they would have to disclose sufficient information, including separate reports on both the banking and insurance segments. In addition to the DNB's wish to have separate reporting, there was another point that should be taken into consideration. The DNB strives for congruence between the annual reports of banks and the *maandstaten*, monthly reports, which banks have to submit to

¹² This was because financial reporting by banks is a responsibility of the Department of Finance. There are close ties between the DNB and the Finance Department.

¹³ Interview with S. Wortmann (Department of Justice) on September 5, 1994.

the DNB. Such congruence means that financial institutions have less costs in complying with reporting requirements.¹⁴ One could also contend that the DNB has an interest in controlling the knowledge gap between the general public as a user of annual reports and itself with the additional information from the monthly reports. Should this gap become too wide, the general public could point to the DNB in the case of a bank failure, accusing it of inadequate supervision and not informing the public in time. However if the gap is narrow, such accusations have less effect. Consequently, DNB favoured adequate disclosure by financial institutions.

Thus, although the DNB agreed upon the consolidation issue, i.e., banks and insurance activities may consolidate, it maintained its position that separate information should be provided in addition. The DNB had not foreseen, at the time of the EC meetings, that financial conglomerates were to become an issue. Therefore, at that time, the DNB considered the item of minor importance. However, by the time it became clear that financial conglomerates were established, the DNB strongly advised additional disclosure in case of consolidated reports on bank and insurance activities. Moreover, the DNB advised not to lay down any further requirements in law until the EC formulated its own stipulations. The Justice Department did not consider this advise to be in the interest of financial conglomerates since such EC requirements would probably take a great deal of time to formulate and the outcome of the EC regulatory processes are not readily predictable.¹⁵ Therefore, they strived to have the whole matter laid down in law, before the EC formulated its own views.

The banking Directive should have been incorporated into national law on December 31, 1990. However, the implementation of the Directive in the form of a draft law took until June 1991 owing, as explained by the ministers of Justice and Finance,¹⁶ to the complexity of the matter and the *intensive deliberations* with the parties involved (Explanatory Memorandum 22169 no. 3, p. 3).¹⁷ According to Wortmann¹⁸ of the Justice Department, it is policy to encourage involvement of the companies to which a draft law pertains if the proposed legislation deals with highly complex and technical matters as financial reporting. Indeed, the department took initiative to contact *inter alia* AMEV, one of the constituting companies of Fortis to discuss reporting by financial conglomerates. In their Explanatory Memorandum, the ministers stated that, with regard to the consolidation of banks and insurance companies which are members of the same group, further study was necessary. This in view of the fact, that on completing the banking Directive, it was not foreseen

¹⁴ Interview with R.E.K. Boezer (DNB) on September 29, 1994. Boezer does not agree with Wortmann's opinion that DNB made a trade-off between reporting issues and its supervising tasks. Het carries the point that DNB deals separately on both issues with financial institutions.

¹⁵ Interview with S. Wortmann (Department of Justice) on September 5, 1994.

¹⁶ Two ministers were involved in this legislative process. First, Aad Kosto (PvdA, Labour Party), *Staatssecretaris* (Deputy Minister) of Justice, defended the draft law in parliament, and was spokesman on the issue. Second, Wim Kok (Labour Party) was involved as Minister of Finance.

¹⁷ When a minister submits a draft law to parliament, he adds an Explanatory Memorandum which contains the history of the draft, the advise offered by representative organisations and an explanation of the purpose and content of the law. The number after 'Explanatory Memorandum' refers to the number of the draft law involved, in this case, 22169. The following number, preceded by the abbreviation 'no.' refers to the number of the document pertaining to a draft law, in this case, document 3 which is the Explanatory Memorandum.

¹⁸ Interview on September 5, 1994.

that banks and insurance companies would be able to form a financial conglomerate. Therefore, it was not foreseen that consolidation of both activities would become an issue. No rules were laid down pertaining to organisations with equally important banking and insurance activities. The ministers also planned to take the forthcoming insurance Directive into account in formulating, at a later stage, their view on the consolidation of activities within a financial conglomerate.

Despite these qualifications, the ministers voiced some of the preliminary opinions which were described in a previous section. These views were also part of the Explanatory Memorandum. The ministers argued that consolidation should not too readily be judged as conflicting with the insight requirement. In their opinion, no other rules applied to the financial conglomerates with equal shares of banking and insurance activities than those formulated in the fourth and seventh EC Directive. Kosto and Andriessen announced that a workgroup had been formed consisting of industry members, which was to offer advice on the reporting requirements of financial conglomerates.

In the mean time, the Council of the European Community accepted the Directive on (consolidated) annual reporting by insurance companies (hereafter, the insurance Directive) on December 19, 1991 (PbEG L374 December 31, 1991). During the establishment of this insurance Directive, the insurance industry had intensive contacts with the Dutch Justice Department. These contacts were used by the Department to discuss the reporting requirements of financial conglomerates with industry members. In particular, the contacts with Nationale Nederlanden, one of the constituting companies of ING, were important when the Department formulated its opinion on the reporting matter.¹⁹

On January 31, 1992, the joint workgroup of industry members, representing both the NVB and the *Verbond van Verzekeraars* (VvV) (Alliance of Insurance Companies) presented its advice, entitled '*Verslaggeving financiële concerns*' (Financial conglomerate reporting). Four items were dealt with in this advisory paper, namely, consolidation, segmentation, elimination and valuation. The paper included models for the consolidated balance sheet and P&L of financial conglomerates. According to the workgroup, three kinds of financial conglomerates are possible. The classification of these conglomerates is based on the composition of the group and the position of the publishing company (group leader). When the publishing company is a bank or a holding with primarily banking subsidiaries then the annual report should be based on reporting rules and customs pertaining to banks. Insurance activities have to be mentioned in the consolidated statements and in the notes to those statements. If the company publishing is an insurance company or a holding with primarily insurance subsidiaries, the annual report will have to be published based on rules similar to the previous case. If the company publishing is neither a bank nor an insurance company, then special rules have to be designed and applied (NVB/VvV, 1992: 2-3). It is important to note that the principal argument of the NVB/VvV workgroup read that financial conglomerates have to and wish to present themselves as one unit (NVB/VvV, 1992: 2). It is, therefore, not desirable to require separate reporting by the subsidiaries. The wish to be seen as one indivisible unit is also apparent in ING's proposal to construct a CAO, Collective Labour Agreement, for bancassurance companies, i.e., apart from the CAOs of the banking and insurance industry (FD,²⁰ 03-12-93). Indeed, this position was taken quite emphatically

¹⁹ Interview with W. Badon Ghijben and J.N.C. Kuijper (ING) on September 13, 1994.

²⁰ FD is the (commonly used) abbreviation of *Het Financieele Dagblad* [The Financial Daily], the most important financial paper in the Netherlands (cf. Zeff *et al.*, 1992).

by ING, mainly for strategic reasons, see section 3.6. Confining the presentation of the NVB/VvV-opinions to the items that were disputed, one other item, the segmentation proposal, is of interest. In the NVB/VvV-proposal on segment reporting, the workgroup stated that more detail should be provided in the notes to the consolidated balance sheet and P&L statement to satisfy with the insight requirement and also to comply with the requirements of the banking and insurance Directives. Insight into segment (activity) would have to be given by splitting up the consolidated figures up to the level of earnings before taxes. However, there should be no division of shareholder equity between the segments. Such a division is not in agreement with the '*bedrijfseconomische*' ('business economic' cf. Zeff *et al.* (1992)) characteristics of consolidated reporting. In the opinion of ING, these business economic problems arise because group equity is the only important figure for shareholders of the group. Those shareholders should not be concerned with the allocation of equity over the activities. Reallocation of shareholder equity between the banking or insurance part of the company does not necessarily have special consequences. Such reallocation would be fairly arbitrary. Clients of a particular bank or insurance company within the group should be able to refer the annual reports of that bank or insurance company to be assured of its solvency. Moreover, when segmenting group equity, units which are legally part of the insurance company, could be allocated to the bank activities, because of their character. However, this does not imply that the obligations of the unit to their clients are guaranteed by the equity of the bank-part.²¹ This statement by ING needs some qualification. By the time of publication of the ING 1991 annual report, it was not clear whether separate reports would be issued by the NMB-Postbank or other subsidiaries of ING. Indeed, spokesmen at ING at the time of publication contradicted each other on this matter (FD, 02-05-1992). Consequently, ING's comment on the business-economic argument is not valid, as this argument was used in 1991 at which time ING did not know whether it was going to publish separate reports on the subsidiaries.

As stated above, the workgroup presented some models for reporting. With regard to companies with primarily banking or insurance activities, the workgroup referred to the models of the DNB and the Verzekeringskamer, though these models required the disclosure of additional information in order to reflect the material insurance and banking activities, respectively. The model pertaining to financial conglomerates was, however, new. In the discussion of the reaction of the companies involved an analysis was done of which companies reflected this model in their annual report. It is important to note that the Justice Department initiated and stimulated the joint NVB/VvV-advisory activities, and agreed with its general terms. During the writing process there was contact between the Justice Department and the workgroup. However, within the Justice Department it was felt that there was some disagreement between the members of the workgroup, in particular between Fortis and ING, on the segmentation issue. Therefore, Wortmann, who was responsible for the preparation of the draft law, began to formulate some stipulations regarding this segmentation issue before the paper was published. It was in the interest of the Department of Justice and the industry to have a shared line of conduct in financial reporting. If controversies on the reporting issue led to totally incomparable annual reports, the EC would have more reason to speed up its regulatory process and impose a standard. Moreover, a shared line of conduct would make a favourable outcome of parliamentary deliberations more likely.

²¹ Interview with Badon Ghijben and Kuijper (ING) on September 13, 1994.

Parliament, i.e., the Second Chamber,²² waited until the publication of the industry advisory paper before starting its 'preparatory investigation' of the draft law in a legislative committee in the first quarter of 1992. In their Provisional Report, the members of the Christian Democratic Party (CDA) stated that they were somewhat disappointed by the industry advice. Indeed, the CDA spokesman, Thomas Vreugdenhil MP, stated that this advice was clearly a compromise. Vreugdenhil implied that there clearly must have been significant controversy on this issue between the members of the workgroup. Logrolling had probably taken place, giving ING's opinion priority on this issue. Consequently, the advice was not considered very important by Vreugdenhil.²³

In the CDA's opinion, one of the driving forces behind the banking Directive was the comparability concept. Leaving out equity as irrelevant was, according to the CDA, typical of the lack of comparability between financial conglomerates and banks and insurance companies that would result from implementing this advice. The CDA's demand was that separate consolidated annual reports of both the banking and insurance group should be provided in addition to the annual report of the whole conglomerate (Provisional Report, 22169 no. 4: 1-2). Notable was the CDA's stress on the comparability argument, which conflicts with the leading principle of Dutch financial reporting regulation, insight. One could question whether a chapter on bank reporting based on comparability would fit in the title 9 system of the Civil Code which is based on 'insight'. Again, it was Vreugdenhil who stressed comparability. As a former partner of the international firm of Price Waterhouse, he was familiar with Anglo-Saxon norms in standard setting, with its emphasis on comparability. Furthermore, Vreugdenhil attached a great deal of value to the interests of investors, which would be served by comparability. Indeed, a large investment firm called Vreugdenhil's attention to the need for the comparability of annual reports. Although Vreugdenhil visited several financial conglomerates,²⁴ it was the investor's interests which had influenced him most profoundly.

At this stage of the regulatory process only the Christian Democrats made remarks regarding the financial conglomerates. The ministers, Kosto and Kok, answered the legislative committee in a Memorandum of Reply (22169 no. 5: 2-3). They again expressed their opinion that financial conglomerate reporting is not subject to the rules pertaining to banks or insurance companies. In the present situation, without any guidance by existing rules abroad or in the Netherlands, the initiative of the NVB/VvV should be appreciated as it was the first attempt at mapping the problems and furnishing some solutions. With regard to the irrelevance of equity the segmentation, the ministers stated that the existence of financial conglomerates was a relatively new development. The special characteristics of financial conglomerates, i.e., the entanglement of both banking and insurance activities, should be expressed in their annual report. In particular, the consolidated annual report of the whole economic entity, the financial conglomerate, is of importance. In view of the special properties of banks and insurance companies, and their prominent position in society, financial conglomerates cannot suffice with this consolidated information. Owing to the separation of banks and insurers in the past, it is possible, at present, to provide information about the separate activities. The question, according to Kosto and Kok, is in which fashion the additional information should be offered and what level of insight is sufficient. The ministers suggested that insight should be offered into both activities

²² Parliament consists of two Chambers of which the Second Chamber is the politically more important.

²³ Interview with Th. O. Vreugdenhil on August 17, 1994.

²⁴ Vreugdenhil visited ABN-AMRO, ING, RABO, and Credit Lyonnais Bank Nederland.

in accordance with the discerned Directives. This proposal was formalised in a Memorandum of Alterations (*Nota van wijziging*, 22169 no. 6: 1) pertaining to article 406, to which three new paragraphs were added of which paragraph 4 and 5 are relevant to the issue at hand. The ministers argued that their proposal was in line with the NVB/VvV advice. It should be noted that the Minister of Justice initially did not intend to set down these requirements in law. The initial plan was to let the NVB/VvV suggestions be the (informal) standard, without any legislative backing. However, owing to political pressures (Vreugdenhil) and the explicit wish of the DNB for there to be legislative requirements on this issue, the new paragraphs of 406 were implemented.²⁵ In hindsight, both the Department of Justice and ING, as a major contributor to the NVB/VvV advisory paper, concluded that the advice was of little relevance to the resulting regulation, in contrast with *ex ante* expectations. One of the most important statements in their Memorandum of Reply was that the ministers did not wish to commit themselves to *the way* in which insight in both activities should be provided. They insisted that there would be an ongoing entanglement of both activities. The requirement of separate consolidated annual reports could lead, in due time, to statements which do not offer a reliable picture of the financial situation per segment, owing to the large number of arbitrary allocations, and the unravelling of what is in fact an indivisible economic entity. However, when financial conglomerates feel that the demanded insight is best provided by separate annual reports, they would be free to issue such reports.

In summary, because of the growing impossibility of distinguishing between banking and insurance products and activities the ministers proposed that insight, as a general and quite broad requirement, should be provided into the whole entity as well as both activities. Managerial discretion would determine the most adequate way of offering such insight. This ministerial proposal was in line with the joint-industry advice.

At this stage of the policy process, there was consensus about consolidating banking and insurance activities into one annual report. Difference of opinion between the ministers and industry, on the one hand, and the CDA, on the other, existed on the subject of the format by which insight into the discerned activities should be offered.

The final report of the legislative committee emphasised this difference of opinion. The CDA members reacted to the ministers' Memorandum of Reply by stating, that although the entanglement of banking and insurance activities might theoretically prevent the separation of both activities in separate reports, in practice, management of financial conglomerates would still want to know whether a certain activity is profitable or efficient. In other words, it is unlikely that the separation of both activities is impossible, owing to the need of a company's managerial control. The CDA also mentioned to the position of the supervising institutions. These institutions would also require segmented equity information. The CDA argued that the ministers' noncommitment to the way in which insight in separate activities should be given, was in conflict with the EC Directive and with the proposed changes of article 406, which from this perspective implied that disclosure of the equity of the banking segment was necessary. It is interesting to note that the CDA referred to the Fortis annual report as an example of the possibility for disclosing the banking segment's equity. Indeed, according to Vreugdenhil, the Fortis report convinced the CDA that it was possible to provide insight

²⁵ Interview with Wortmann (Department of Justice), on September 5, 1994 and with Boezer (DNB) on September 29, 1994. The DNB not only wished to have legal reporting requirements, they also were in favour of only limited options open in reporting to the companies involved. Limiting freedom in reporting would facilitate comparability, which is one of the prime goals of the DNB.

into both activities, separately. Moreover, this conviction was strengthened in a conversation with Y. van der Schaaf-Visser, head of Group Accounting at Fortis, based on an article by van der Schaaf in FEM, a financial biweekly. It is interesting to note that ING also contended that there were only a few technical obstacles in separate reporting.²⁶ Thus, although the ministers accentuated accounting problems with separate reporting, the companies involved readily admitted that such problems were not the major issue.

In the same report (Final Report 22169 no. 7: 2), the members of the Labour Party (*PvdA*) also questioned the noncommitment of the ministers with regard to the manner in which insight should be given.

The ministers, thereupon, responded in a Memorandum in account of the final report (*Nota naar aanleiding van het Eindverslag* 22169 no. 8). They stated that, in their opinion, it would not be possible to act in conflict with the EC Directives since neither the banking nor the insurance Directive made any provisions regarding mixed financial companies. The ministers argued, furthermore, that although it was indeed uncertain whether banking and insurance activities would become so entwined that reporting on separate activities would become arbitrary, both management and supervising institutions would have sufficient instruments to obtain necessary insight into the financial position, regardless.²⁷ Moreover, the ministers found the CDA members to be correct that as a result of art. 406 paragraph 4 and 5, the equity of both banking and insurance activities would have to be disclosed in some fashion in the segmentation. Furthermore, the minister announced that advice had been asked of the Council on Annual Reporting regarding the way in which insight should be provided (i.e., the concrete elaboration of paragraph 4 and 5 of art. 406).²⁸ This request for advice should be seen as a diversionary manoeuvre, the intention of which was to get the proposed article 406 implemented without further changes.²⁹ One should note that this art. 406 left considerable freedom to the financial conglomerates regarding their reporting. Indeed, it was formulated in such a way that it suited both ING and Fortis, the parties which had the most contrasting opinions.

This reply of the ministers was the somewhat sudden (provisional) end to the problem. The proposed article 406 was enacted without further changes and the matter was not a point of discussion on the floor of the Second Chamber (Proceedings *Handelingen* TK 20-1481). The First Chamber did not have any comments on the issue of financial conglomerates.

3.5 *The legislative process part 2: the insurance Directive incorporated*

This was not the end of the story, however. On December 19, 1991, the Council of the European Community accepted the proposed Directive regarding the (consolidated) annual reports of insurance companies (PbEG L374 December 31, 1991). The draft law to incorporate the Directive into Dutch law was submitted to Parliament on November 5, 1992. In the Explanatory Memorandum (22896 no. 3: 23) Kosto and Kok stated that financial conglomerates, i.e., mixed financial companies with equal shares in banking and

²⁶ Interview with Badon Ghijben and Kuijper (ING) on September 13, 1994.

²⁷ Indeed, the Justice Department itself regarded the entanglement argument to be weak. Nonetheless, it was considered convenient in parliamentary discussions.

²⁸ The Council on Annual Reporting established thereupon a workgroup, whose members were: J. van der Plas (Moret, Ernst and Young, auditor of ING), J. Buitendijk (ING), A.F.M. van Klaren (CNV/FNV -union-), O.L.A.M. Spaan (ABN/AMRO), M.H.Th. Steunebrink (NIVRA -auditor-), Prof. F. van der Wel (auditor/academic) (RJ, 1993: 4).

²⁹ Interview with Wortmann (Department of Justice), on September 5, 1994.

insurance activities, should report in accordance with paragraph 4 and 5 of article 406.

In its report (Report, 22896 no.5: 1) the CDA members of the legislative committee once again stressed the comparability concept. They argued that it was desirable that the insight of the general public into the financial position of insurance companies be enlarged. Apparently, in the CDA's opinion, comparability is a manner of increasing insight into the financial position of a firm, in the CDA's opinion. With regard to the financial conglomerates, the CDA favoured an organisational structure with a topholding and two subholdings which supervised the banking and insurance activities, respectively. Each holding should publish a consolidated annual report, so that the financial position of the whole conglomerate as well as its constituting parts would become visible. The CDA members indicated that they were willing to lay down such a structure in law. The idea behind this proposal was that such an organisational structure would make life easier (for the investor). Moreover, the supervising institutions, would be provided with a clear distinction between banks and insurance companies.³⁰

Labour Party members (Report, 22896 no.5: 2) also emphasised the comparability of the annual reports of insurers. These members joined the CDA in their opinion that insight into financial conglomerates should be enlarged by laying down requirements to disclose banking and insurance activities. Such requirements would also benefit the supervisors, in this case the DNB and the Verzekeringkamer.

The minister replied (Memorandum to Report, 22896 no. 6: 2) that, in accordance with article 406, financial conglomerates have to disclose in their notes dealing with the principal consolidation, *behoorlijk wat*, i.e., substantial, data pertaining to the separate activities. These stipulations were incorporated in law because it was feared that without such requirements a top holding company could publish just one consolidated annual report without providing any insight into the separate activities.

Apparently, the CDA members of the committee were not satisfied with this answer. They did not consider the disclosure of substantial amount of data in the notes on the consolidation of the top-holding to be sufficient. They once again suggested that requiring two consolidated annual reports, one for each activity (*Verslag van een schriftelijk overleg* Report on written deliberations, 22896 no. 8: 2). The minister repeated his view that consolidation of both activities in the annual report of the top holding was in line with the European Directive regarding consolidation (Directive no. 7) and was, in view of the ongoing entanglement of the aforementioned activities, justifiable with regard to the required insight. Therefore, according to the minister, it was stipulated in article 406 that consolidation is allowed, but that separate information about bank and insurance activities was required, in accordance with the EC Directives regarding both activities.

This answer was still not satisfactory to the PvdA and CDA, and the MP's Vreugdenhil (CDA) and Vermeend (PvdA) submitted an amendment to article 406 in which the separation of information on banking and insurance activities was laid down. Formally, a new paragraph 6 was added to article 406, which demanded the separation of information about the balance sheet, *in accordance with the form requirements of the EC Directives*. The separation should at any rate provide insight into the equity of the bank and insurance activities, respectively. Through this amendment, the noncommitment of the ministers regarding the manner in which insight should be given, was put aside. Instead of the relative freedom in the presentation of data that the ministers (and industry) advocated, the framework and requirements of both EC Directives were imposed. Information pertaining to separate activities within the banks or insurance companies was not required. This amendment was then taken up by the minister who submitted a Second Modificatory Memorandum (22896 no. 11) containing the stipulations of the amendment. The draft law was subsequently

³⁰ Interview with Th. O. Vreugdenhil.

accepted by parliament. It was the intention of Vreugdenhil to defend his amendment on the floor of the Second Chamber. Kosto was advised to resist the amendment, although the Justice Department did not consider it probable that the amendment would be withdrawn. Pure coincidence hindered a plenary treatment in the Second Chamber. The plenary treatment of the draft was scheduled for June 30, 1993. On that day, however, the chairman of the Second Chamber, Deetman, decided to cancel the treatment of the draft. This cancellation caused some distress to the Justice Department, because the law was to be implemented within six months and still had to be submitted to and debated in the First Chamber. Therefore, the Justice Department, taking into consideration that the Vreugdenhil/Vermeend amendment had a majority in the Second Chamber and that, therefore, the probability of withdrawal was nil, took up the amendment in exchange for Vreugdenhil's renouncement of deliberation on the floor of the Chamber.³¹ The First Chamber did not make any comments on the proposal. A question that remained to be answered, is what triggered Vreugdenhil and Vermeend's amendment, in which the form in which insight should be provided was laid down, including the requirement pertaining to the segmentation of shareholder equity. Two factors seemed to have played a role. First, a high ranking officer of ING, Badon Ghijben, maintained in a conversation with Vreugdenhil that article 406, in the form that resulted after draft law 22169 was accepted, did not compel financial conglomerates to report separately on banking and insurance activities in accordance with the form requirements of the EC Directive nor did it compel these companies to segment shareholder equity. Indeed, the 1992 ING annual report did not report on the segments at the level of shareholder equity. Second, Kosto announced in the parliamentary treatment of the bank draft, that he would ask the advice of the Council on Annual Reporting on the matter of the application of article 406 in the case of annual reporting by bank/assurance companies (financial conglomerates). A source from within the Council stated informally to Vreugdenhil that the Council was not able to reach agreement on this advice. The workgroup, instated by the Council, advised not to disclose segmentation information on shareholder equity, in line with ING's position.³² The advice of the Council's workgroup met with resistance within the Council. In particular, the auditors and users delegation objected to the implications of the advice. They were in favour of disclosure. Vreugdenhil observed that ING again was the obstructing party in the failure to reach an agreement.³³ In Vreugdenhil's opinion ING would have considerable influence on the employers' delegation in the Council on Annual Reporting, as it was a large contributor to the funds of the Federation of Dutch Industries (VNO). In conclusion, the obstruction of the implementation of article 406 by ING led to the Vreugdenhil/Vermeend-amendment.

3.6 *Field reactions: the companies involved*

In Section 3.2, it was described how starting in 1990 insurance companies and banks were allowed to merge. This implies that the companies involved in this bancassurance case, are relatively new in their present form. In 1992, twelve financial conglomerates were registered in the Netherlands (Van der Tas 1993). Of these twelve companies, five were established in 1992, which means that only seven financial conglomerates existed in 1991. At least three financial conglomerates were formed in 1990, namely Fortis (combination of

³¹ Interview with Wortmann (Justice Department) on September 5, 1994.

³² Interview with Badon Ghijben and Kuijper (ING), on September 13, 1994.

³³ Indeed, another high ranking ING officer was a member of the workgroup which prepared the advice, namely J. Buitendijk.

AMEV, AG and VSB), RABO (bank with insurance company Interpolis) and Reaal (combination of Reaal Verzekering, Centrale Volksbank and Hollandse Koopmansbank NV). This group was enlarged in 1991 when ABN and AMRO merged into ABN-AMRO. Aegon NV (insurance company with Bank Van Haften Labouchere and FGH Bank), Internationale Nederlanden Groep (ING, a merger of Nationale Nederlanden and NMB Postbank), Levob (insurance company with OV Bank NV) were also established in 1991. The 1991 annual report will be the one at the center of attention, because no regulation had yet been implemented, so this report is the most likely to reflect the preferences of the companies involved. Using 'share in turnover' as a classification measurement, Van der Tas (1993) proposed the following classification of the companies mentioned:

Insurance group with bank activities: Aegon, Fortis and Levob.

Bank group with insurance activities: ABN-AMRO and RABO.

Mixed financial company: ING and Reaal.

In the 1991 annual report of all seven companies both banking and insurance activities were consolidated. Van der Tas (1993) shows that ING and Reaal copied the proposals (model) of the NVB/VvV workgroup for both the balance sheet and the P&L. ING adhered more closely to the proposal than Reaal. Remarkable is the Fortis annual report which also applied the mixed financial company format, although it was not truly a mixed financial company. The annual report of Fortis had some other features worth mentioning, these are discussed below (see also FD, 4-2-1992). To illustrate the relative importance of the seven companies mentioned some selected financial data are presented in Table 3.1. Table 3.2 reflects the segmented information provided by the companies.

The observation that ABN-AMRO does not provide any separate reporting may be explained by the fact that the insurance activities of ABN-AMRO are marginal, so that the contribution of insurance activities to the consolidated result may not be material. Table 3.2 facilitates the conclusion that Fortis discloses the most information. Fortis holds a somewhat special position in this case, since it is a transnational merger, being the result of the merger between the Dutch VSB/AMEV and the Belgian AG. The choice for separate reporting of bank and insurance activities may be attributed to the special structure of Fortis, i.e. Fortis has two parents, AG Group and N.V. AMEV, which themselves are not part of Fortis. Both parents have a 50% interest in Fortis, via a 50% interest in AG 1824 and AMEV/VSB 1990. The AG Group participates in AMEV/VSB 1990 by means of its 94%-subsidiary AG 1990 N.V. and the 100%-subsidiary of the latter, AG 1990 (Netherlands), in which they perform their operational activities.

One important question remains to be answered, and that is why was it that ING was the foremost opponent to the requirements of (the draft) law? In the observation of Vreugdenhil MP, the reason was that of the companies constituting the ING, namely, NMB-Postbank and Nationale Nederlanden, NMB-Postbank had the weaker shareholder equity position. In the merger process, significant transfers of equity funds had taken place to strengthen the NMB-Postbank's equity position. NMB-Postbank itself was established as a result of a merger between NMB and Postbank. It was NMB which had previously committed itself to an aggressive market policy which inherently meant a high risk. This high risk had had its effects on NMB's shareholder equity. Vreugdenhil based his observation on an internal source within ING. Table 3.3 provides the equity development of ING and NMB-Postbank in the relevant years.

ING denied that equity transfers were the reason for their rejection. Instead, they stated that they had wished

to present themselves as one indivisible unit. This wish had a strategic origin. Some (financial) analysts had doubted the feasibility of financial conglomerates (Keiser, 1993; FD, 6-08-1993; Barkema, Douma and Steins Bisschop, 1992). ING therefore, did not wish to emphasise the fact that it was the result of a merger between two fields which previously were thought to be impossible to unite. In a way separate reporting would signal to investors that the critics were right, and that even ING was not certain of its own success.³⁴ While ING did not favour the segmentation proposal, in the end it acknowledged that it was very likely that this proposal would become law. At that time, ING changed its strategy; as was noted before, ING's finance officer, Badon Ghijben had a conversation with Vreugdenhil in April 1993. In this discussion, Badon Ghijben tried to convince Vreugdenhil that segmentation of shareholder equity would not provide useful additional information to the users. When this argument failed Badon Ghijben put forward another aspect of the insurance draft which was considered undesirable by the insurance-industry. Under the draft law (22896), it was not permitted not to depreciate real estate which was used by the company itself [Explanatory Memorandum 22896, no 1-2: 9). Although there had been intensive discussions between the Justice Department and industry on this point, the department had not given in³⁵. In a letter to the Chamber's legislative committee, the Verbond van Verzekeraars had already asked the committee to amend this point. Badon Ghijben now suggested to Vreugdenhil amending the draft in accordance with the wishes of the industry. This could then be seen as a trade-off between the segmentation and the depreciation-issue.³⁶

3.7 *Field reactions: auditor involvement*

The market for audit services in financial conglomerates is characterised by a duopoly. Two audit firms divide the market between themselves: Moret, Ernst & Young (MEY) and KPMG Klynveld. The market is not stable, however. KPMG has lost some ground to MEY in recent years. Table 3.4 provides more detail of market developments.

Analysis of the opinions of the auditors does not provide much insight into their position with regard to the question at hand, that of separate reporting. Most published statements are merely explications of the requirements of law (e.g., MEY, 1990; KPMGa/b, 1993; De Haan, 1993a, 1993b). However, in presenting the MEY annual report 1991, Prof. A. Bindenga, MEY vice chairman of the board of MEY, stated that it was the opinion of MEY that separate reporting was required for those financial conglomerates which had equal shares of bank and insurance activities. Bindenga proposed three-column reporting, which would reflect the specific capital structure and interest margin of the banking activities and would also provide insight into the ratio between investments and long-term obligations. Finally, a consolidated statement would provide insight into the total financial position and results (FD, 25-03-92). This statement by Bindenga is interesting. Primarily, because it seems that the clients of MEY do not share Bindenga's opinion. In their annual reports, separate reporting is only present to a very modest degree. It is also of importance because of the timing. Bindenga made his statement after the joint NVB/VvV advice was published, but before Parliament discussed the draft law. Moreover, it should be noticed that Bindenga's ideas contrasted with the proposals made by NVB/VvV. Although remarkable, Bindenga's views did not seem to have an important impact on

³⁴ Interview with Badon Ghijben and Kuijper (ING), September 13, 1994.

³⁵ According to ING, Prof. Van Hulle, responsible for reporting issues in the EC, agreed with ING and the insurance industry on this point. (Interview with Badon Ghijben)

³⁶ Interview with Vreugdenhil on August 17, 1994 and with Badon Ghijben on September 13, 1994.

the political process, since Vreugdenhil was not aware of Bindenga's statement. This does not imply that Bindenga's statement went by unnoticed. The Justice Department was somewhat concerned that one of the largest auditing firms in the country, appeared to take a position which clearly diverged from the Department's policy. A civil servant at the Justice Department contacted MEY, in order to find out whether this was indeed an official position taken by the firm regarding this issue. MEY made it clear that there was no such position and that Bindenga's statement reflected only his personal views.³⁷ That Bindenga's statement did not go by unnoticed, is also clear in the reaction of ING-official, Badon Ghijben. ING was audited as is shown in Table 3.3, by MEY. The responsible auditor at MEY, Van de Brande, held quite a different opinion on the issue than Bindenga. Indeed, Van de Brande was one of the people who supported the idea that ING should present itself as one indivisible unity. Badon Ghijben stated in an interview that he was not pleased with the statements by Bindenga. He felt Bindenga's statement to be a result of a lack of knowledge on the issue.

One other auditor's opinion is worth noticing. Prof. F. van der Wel, a partner at TRN, asserted on several occasions that financial conglomerates should report banking and insurance activities separately (Van der Wel, 1991a, 1991b, 1992). TRN however, does not perform any audit services for the financial conglomerates, so that Van der Wel's statements can be considered as opinions of an academic more than of an auditor. Van der Wel played another role, which seems to conflict with his statements in writing. The Council on Annual Reporting's workgroup, which he chaired, proposed *not* to disclose information on segments' shareholder equity.

3.8 *Field reactions: the financial press*

The reactions of the financial press on financial conglomerates and their reporting ranged from critical to outright hostile. Editorial comments on the developments of reporting by financial conglomerates appeared in *The Financial Daily* and *FEM* (Financial and Economic Magazine), a financial biweekly. Some headlines are presented here to give an impression of the attitude of the press with regard to financial conglomerates. 'Annual report ING offers even less than ABN-AMRO's.' (*Jaarverslag ING biedt nog minder dan ABN AMRO*) (FD, 02-05-1992) 'Hymn of praise on bancassurance is silenced.' (*Loflied op verzekerbanken verstilt*) (FD, 13-11-1992). 'Financial conglomerates offer farrago.' (*Financiële concerns maken ratjetoe*) (FEM, 13-06-1992) 'Insurers, more realism please!' (*Verzekeraars, meer realisme graag!*) (Hers, 1993) 'Insurance lobby scores.' (*Verzekeringslobby scoort*) (Hers, 1993) 'Down with All Finanz!' (*Weg met All Finanz!*) (Keiser, 1993).

The general line in the press comments is that important companies as banks and insurers should provide enough information for the reader of annual reports to obtain a good insight into the affairs of the company (see, for example, FD, 02-05-1992 and FD, 13-11-1992). In particular the (alleged) concentration of power in financial conglomerates is of concern to the financial press. It is stated that more disclosure and a better annual report could contribute to the insight into the affairs of financial conglomerates. Moreover, the concentration of power should lead to increased supervision by the DNB and the Verzekeringkamer.

FEM stressed furthermore the comparability of the reports of financial conglomerates with those of other companies. Their opinion was that the exception Dutch law makes for insurance companies and banks pertaining to their reporting requirements should be abolished in order to make comparisons possible and in order to obtain '*commercieel realisme*' (commercial realism) in their annual reports (e.g., Hers, 03-05-1993).

³⁷ Interview with Wortmann (Department of Justice), on September 5, 1994.

CDA MP Vreugdenhil indicated that he used the articles in FEM in forming his opinion on the matter at hand. Although FEM seems to have an important signalling function in the political process, Vreugdenhil expressed annoyance with the negative and sometimes hostile tone in the articles. This annoyance was shared by Wortmann at the Department of Justice.

4. *Discussion and analysis of results*

In this section, the predictions of pluralist theory as described in Section 2 will be compared with the result of the case study from the preceding section. The discussion will start with the prediction of the equilibrium, i.e., the prediction of the result of the regulation process, and the point of view it will concur with. Furthermore, the prediction regarding the behaviour of the players involved will be discussed. If pluralist theory lacks explanatory power (on some issues), the alternative theories of Section 2 (elite, Marxist and corporatist) will be applied to explain behaviour.

Pluralism offers a picture of the regulatory process in which unequally powerful interest groups, among which politicians and bureaucrats, compete for favours. It is argued that the degree of influence of the competing interest groups depends on their resources. Although politicians compete for votes, they will not necessarily favour majorities in their regulation. The legislatures take from those who are least capable of resisting the demands for wealth transfers and give to those who are best organised for pressing their demands (McCormick and Tollison, 1981). In Section 2, the prediction was formulated that since preparers are wealthier than consumers, the preparers' lobby efforts will be more ardent. Furthermore, their lobbying was expected to result from existing organisational forms, such as industry associations, owing to cost-sharing problems and start-up costs.

Indeed, empirical evidence in this case substantiates the predictions of pluralism. It was primarily the preparers who lobbied. They had intensive contacts with the Justice Department in the drafting phase of both laws, and before that they were involved in European discussions pertaining to the discerned directives. Also, they contacted Thomas Vreugdenhil MP, trying to convince him of their point of view. Moreover, an important part of the lobbying was performed within the structure of a joint initiative of the two industry associations involved, the NVB and VvV. Although one could argue whether this structure is an established lobbying forum, it seems reasonable to suggest that this joint initiative is not an ad hoc group. The joint NVB/VvV workgroup was supplied secretarial support by NVB. The workgroup was formed by members of both industry associations.

The group of companies involved is not homogeneous as was pointed out in Section 3. ING is by far the most important financial conglomerate (with equal shares of bank and insurance activities). Fortis has some importance, as well. It was suggested that large companies would carry the burden of lobbying efforts owing to the free rider problem. Indeed, ING appeared to be the most active lobbying party. Even Fortis, which was certainly involved in the process, for example, in its contacts with the Justice Department and in the formulation of the NVB/VvV advice, did not seem to have played an active part. Indeed, the contacts with the Justice Department were the result of initiatives on the part of the department itself. Therefore, the prediction that large companies, with significant interests in the regulatory process, will perform the lobbying activities, is corroborated. We have seen that there has been both collective and individual action on the financial conglomerates' issue. Collective action took place in the environment of the industry associations, thereby providing sufficient warranty against free riding. Although some companies seem to have been dominant in these collective actions, all of the important companies provided input. However, since the

expected benefits were apparently large enough, individual influence actions were undertaken by ING. Lobbying also seems to have penetrated the standard setting body, the Council on Annual Reporting. In the workgroup of this Council, ING's position was supported. Afterwards, in deliberations on the floor of the Council, the representatives of the employers' organisations, also readily supported ING's position.

Comparing the 1991-annual reports of the financial conglomerates with the NVB/VvV-proposal, it appeared that ING's annual report concurred best with this proposal. Therefore, and in light of the result of the interviews, it seems reasonable to suggest that logrolling took place in favour of ING's preferences. The conclusion seems all the more legitimate because Fortis, the other major player in the field, had a completely different disclosure preference.

Some predictions were also formulated regarding the lobbying methods that would be applied. It was suggested that the choice between lobbying methods would be based on cost-effectiveness, the importance of the issue, the question whether a certain position was more or less disputed, and the cultural and historical background of the parties involved. To start with the last element, one of the respondents pointed out that it was unlikely that captains of industry would participate in demonstrations. Indeed, most lobbying occurred through some form of information transfer. It is interesting to note that the government itself explicitly solicited such information transfer (NVB/VvV-advice). Not only did the industry transfer information by publishing an advice, it also participated in the exchange of views while the new legislation was being debated. With regard to the timing of lobbying, the prediction was that the effective lobbying would occur as early in the process as possible. Indeed, as one respondent observed, lobbying was likely to be most successful when it took place even before a civil servant sets pencil to paper for the first time to write a proposal. However, there were some related issues regarding financial conglomerates that lead to the conclusion that Amershi's *et al.* [1982] warning has to be taken serious in this case. For example, ING and the insurance industry fiercely objected to the proposed rule regarding the depreciation of real estate in own use. This rule was eventually traded against the equity segmentation issue. The DNB on the other hand, was initially given a large role in the formulation of reporting requirements for banks. The Second Chamber opposed the delegation of rule-making power to a private institution, such as the DNB. This was a surprise to the DNB, since it was not informed by the Justice Department of the pending rejection by the Chamber of the proposed draft.³⁸ It is not unlikely that this experience influenced the segmentation issue. In particular, it should be considered that Vreugdenhil had received internal information from the banking industry stating they were not in favour of a more pronounced role for the DNB in the standard-setting process.³⁹

Finally, predictions were formulated regarding the content of the preparers' preferences. Based on Mian and Smith's (1990a) finding it was argued that interdependence was a major factor in explaining consolidation

³⁸ Interview with Boezer (DNB) on September 29, 1994.

³⁹ Interview with Vreugdenhil (CDA) on August 17, 1994. The statement by Vreugdenhil reveals a conflict between the official statements of banks regarding the DNB's standard-setting efforts and their 'hidden agenda'. According to Boezer at the DNB, the DNB issued reporting requirements in order to comply with an explicit request made by the banks. Wortmann indicated that these reporting requirements facilitated comparable annual reports and a shared line of conduct, thereby shielding the banking industry from excessive (European) regulation. As Vreugdenhil pointed out, part of this conflict could be explained by the power the DNB possessed in the Dutch financial system. Another explanation could be that the banks feared that the delicate balance of power between regulator (DNB) and regulatees (industry) would be disturbed, by further increasing DNB tasks.

and disclosure preferences. Management has incentives to disclose information, in order to reduce agency costs. However, these incentives may be countervailed by the costs of providing valuable information to competitors, and by the costs of information production. As Consolidation, as a rule, leads to less disclosure, one may expect that consolidation will, therefore, be preferred by preparers (if agency cost reduction is sufficiently small). Furthermore, increased interdependence strengthens the preference for consolidation. The more a company wishes to accentuate the fact that it is an economic entity, the stronger the drive will be for consolidation. The findings of the case suggest that these predictions were fairly accurate. Although the financial conglomerates disclosed quite a lot of information, there was a clear borderline regarding this disclosure: the segmentation of shareholder equity was strongly opposed. This is, in fact, a wish for consolidation that can be attributed to the economic-entity argument. ING repeatedly stated that it wished to show itself to be a whole indivisible unit. A comparable argument was made in the NVB/VvV-advice. The interdependence within financial conglomerates are substantiated by the increasing resemblance between financial services or products (which cannot exclusively be categorised as either bank or insurance product). Moreover, financial conglomerates use the same distribution channels to deliver their services to customers. Also, information production costs enhance interdependence, as was argued in Section 2.

With regard to the lobby efforts of users and their position in the disclosure debate, the following hypotheses were drawn. First, it was stated that users were likely to prefer no consolidations or, when consolidation was allowed, would prefer additional, segmented information. Compared to the preparers of financial statements, users seemed to have less resources at their disposal. Therefore, it was hypothesised that users were unlikely to lobby (intensively). However, in the case at hand, there was a user with substantial resources, i.e., the large investment firm that called Vreugdenhil's attention to the position of the users of annual reports of financial conglomerates. Consequently, the substantial influence of this user is completely explicable within pluralist theory. Apparently, this user committed more resources to the cause of financial conglomerates' reporting than the industry did. The users were important in another aspect of the political process. Both the users' and auditors' delegation in the Council on Annual Reporting were opposed to the proposals of the Council's workgroup which held, grosso modo, the ING policy. Subsequently, the Council could not reach a decision and Vreugdenhil had the opportunity to submit his amendment.

In the end, the users seem to have won the segmentation issue. It is their choice which is reflected in equilibrium.

In Section 2, a few conflicting incentives were identified regarding the position of auditors. In general, the theoretical prediction appeared to be that auditors favour increased consolidation in connection with separate reports on the segments. This prediction was substantiated by two elements: first, audit fees are likely to rise with the complexity of auditing activities: when auditors have to certify not only the consolidated statements but also the separate statements, more items become material and have to be looked into; second, the Haring-Puro hypothesis reads that auditors do not support their clients on disclosure matters.

Although a superficial glance at the case evidence might suggest that these hypotheses were confirmed, more careful examination inevitably leads to the conclusion that, in this case, auditors did support their clients. Bindenga's statement clashed with his clients' interest. However, Bindenga was not supported by other partners at Moret, Ernst and Young. Indeed, the MEY auditor who was most involved in financial conglomerates' reporting, Van de Brande, supported ING's position completely. Bindenga's statement was referred to as an internal communications error.

The conclusion may be drawn that pluralist theory provides fairly accurate predictions in the case of bank assurance in the Netherlands. However, this observation requires some qualification. Several respondents remarked that although a reporting issue may be relevant and important to accountants and researchers, in the every day reality of doing business in the financial market, reporting issues are of minor importance. To illustrate this, I would like to cite Vreugdenhil who stated that if this really was something the large banks were concerned about, they would have contacted the party leader and made a deal with him. In that case, there would not have been anything that he could have done.

Wortmann of the Justice Department frequently stated that de deputy minister did not expect her to bother him with problems in the area of reporting regulation as it was a politically minor issue.

This becomes even more clear when we consider the case from the elite theory point of view. In that case, there are two tracks of argumentation which can be used. First, one could consider the fact that there was discussion on this issue as evidence of the agenda power hypothesis. Those who control the political agenda (the elite) apparently considered the segmentation question a safe issue which could be discussed freely. Indeed, the observation made by Vreugdenhil that the banks could have blocked this point and there would have been nothing that he could have done fits this line of thought. Second, one could argue that in this case it was not the users who won, but merely a big firm: the previously-mentioned large investment firm.

Looking back at the entire political process, the same names and companies appear again and again, both nationally and internationally. Therefore, one could conclude that the access of institutions and persons to political decision-makers is of paramount importance. Such access, then, is specified by the institutional position of the potential participant. Illustrative is the role of the Council on Annual Reporting. Due to the blockade of the users and auditors delegation of the workinggroup's proposals, it became possible to set favourable requirements for users in law. However, the composition of the Council suggests that joining it is not simple. At the least, one requires a thorough knowledge of financial reporting. The representativity of the Council has been an issue of debate in the Second Chamber [22196 no. 7, p.2]. At any rate, membership of this institution provides ample opportunity to influence in accordance with elite theory predictions.

Moreover, the political process as such has characteristics of the neo-corporatist system. On several occasions, the government involved interested parties in the preparation of the regulation. Indeed, it is departmental policy to encourage involvement of the companies in drafting laws pertaining to highly complex and technical matters such as financial reporting. In fact, the Justice Department intended to formulate only very general requirements based on the NVB/VvV advice. This strategy clearly encourages self-regulation. Self-regulation is a way of maintaining harmony and avoiding conflict by allowing interest-groups to share power.

Applying Marxist theory to this case would require a different kind of analysis than was previously undertaken in this paper. This exercise deserves more room than is available in the framework of this article. Tentatively, however, some suggestions for the line of reasoning can be made. The core proposition of Marxist theory is that economic power is concentrated in the hands of few. Political power is connected to economic resources. The inequalities in social-economic relations will be reflected in the political process. As noted above, players in the bancassurance case were largely the companies directly involved. In other words, influence has been exercised by those in charge of vast economic resources. Those without possessions had no vote at all in the process. Some evidence might also be found in the amazement of Wortmann at the Justice Department, when she was asked whether she had contacted users of financial reports such as unions,

the financial press, or analysts. Not only did she not contact these groups, she had not even considered the possibility.

5. *Conclusions*

This study examined the political process leading to the promulgation of promulgating the draft laws 22169 and 22896, pertaining to the reporting of financial conglomerates, the lobbying efforts observed during the process and the interaction between the government, the supervisors of banks and insurance companies, the industry and its associations and the users and auditors of annual reports of financial conglomerates. The results of the study are consistent with the pluralist theory of the political process. However, owing to the relatively minor importance of the issue, the applicability of pluralist theory in issues that are considered to be threatening to companies is not clear. Other theories on the political process, such as elite, corporatist or Marxist, could prove to be valuable in these circumstances. More research seems to be necessary. Nevertheless, the study provides additional insight into the standard setting process in the Netherlands. One of the most salient aspects of standard-setting in the Netherlands seems to be the importance of sheer coincidence. It was by chance that Vreugdenhil knew someone in the Council on Annual Reporting, and therefore he knew in time that the Council could not reach a decision. It was chance that the insurance Directive was implemented right after the bank Directive, which offered Vreugdenhil the possibility to readress the ministers regarding the segmentation issue. It was a coincidence that the chairman of the Second Chamber, removed the insurance draft from the agenda. Who knows what would have happened if the matter had been deliberated on the floor of the Chamber? The important role of coincidence in accounting regulation may explain why little research has been done into the regulation process. Recently economic theory has taken up issues such as coincidence, history and adaptability. The traditional economic notion of static equilibrium is not adequate for evolution or process problems. Complexity considerations become an important 'explanatory' element. In this 'complexity view' bounded rationality plays an important role. Since everything is connected and consequences of policy are not (readily) predictable, optimality becomes a less significant notion. Then relevant criteria for policy are the viability and applicability of possible alternative actions (Hendrikse, 1994).

This study deviates from most lobbying research in that it takes Sutton's (1984) and Lindahl's (1987) suggestion seriously that accounting researchers need to know more about the standard-setting process. It is difficult to gain knowledge about this process when applying quantitative research methods. Quantitative research usually relies on comment letters to the standard setter to determine the position of the players and the degree of their opposition. Lindahl (1987: 70) argues that comment letters are only one, and not necessarily, the most effective lobbying instrument. Therefore, this study used qualitative methods, in a case-study approach, to provide a different angle to the existing lobbying theory. Qualitative methods have several limitations, one of the most important being the problem of interpreting the words of the respondents. The usual precautions have been taken to enhance the reliability of the results.

An important advantage to case study is that it is possible to focus on related issues and to consider longer periods of time. Indeed, this case study considers the period from 1990-1993. An attempt has been made to illustrate the possible dependences between issues and time periods.

Little research has been conducted regarding standard setting in the Netherlands, that is other than descriptive, historical research (see, for a notable exception, Maijoor (1991)). This study may point the way to future, positive research.

Tables.

theory aspect	pluralism	elite	Marxism	neocorporatism
strategic behaviour vs. efficiency	efficiency	strategic behaviour	strategic behaviour	strategic behaviour
sources of power	unequally but widely distributed	concentrated	concentrated	concentrated
cumulativity of power	noncumulative	partially cumulative	cumulative	partially cumulative
dominance of power source	no single source is dominant	no single source is dominant	property or economic affluence	monopoly of professional expertise
role of government	interest group	power source by occupation of office	power source is instrument of class domination	avoidance of conflict by power sharing
equilibrium	dependent on relative strength of interest groups	dependent on structure/power of institutions	dependent on distribution of property	dependent on degree of compliance of interest groups and the extent of power sharing

Table 2.1. Four Theories of Regulation.

	ING	Fortis	Reaal	Levob	Aegon	ABN/AMRO	RABO
total assets	297,836	72,410	9,625	1,315	71,406	415,090	217,051
group equity	13,954	7,503	763,642	170	5,727	15,982	13,021
premium income	18,858	10,504	500,760	216	7,942	-	212
interest income	25,131	5,469	709,831	101	-	7,348	5,205
commission income	1,075	195	-	-	-	2,778	822
results after taxes	1,602	929	20,974	17	713	1,560	1,016
personnel (1)	51,010	+/- 22-,000	1,506	332	11,090	57,466	39,050

Table 3.1. Financial Highlights of the Companies Involved (in millions of Dutch guilders).

Source: Annual Reports 1991 and Reach

(1): in full time equivalents

Segmentation	Balance sheet	Profit and Loss Statement
ING	investments in nominal values	consolidated result per activity
Reaal	investments, placings and loans	consolidated result per activity except other gains and losses
Fortis	separate consolidated statements for insurance, banking, and general activities	separate consolidated statements for insurance, banking, and general activities
Levob	separation of equity in financial service, other activities, and insurance	no separate reporting
Aegon	no separate reporting	amount and composition of turnover and earning before interest and taxes of non-insurance activities
ABN-AMRO	no separate reporting	no separate reporting
RABO	segmentation of all relevant items in both activities	segmentation of all relevant items in both activities

Table 3.2. Separate Reporting by Financial Conglomerates in 1991.

Source: Annual Reports and Van der Tas (1993).

	1989	1990	1991	1992	1993
ING Group	14,150*	13,874*	13,859	15,597	21,481
NMB-Postbank	4,944	5,346	5,902		

Table 3.3. Consolidated Equity Development: ING Group and NMB-Postbank.

Source: Annual Reports of ING-Group (1992) and NMB-Postbank (1990 and 1991).

	1988	1989	1990	1991	1992
AEGON	Moret & Limperg*	MEY	MEY	MEY	MEY
ABN	KPMG	KPMG	M	M	M
AMRO	Moret & Limperg	MEY	M	M	M
ABN-AMRO	NA	NA	KPMG + MEY	MEY	MEY
AMEV	KPMG	KPMG	KPMG	KPMG	KPMG
AG\AMEV	NA	NA	KPMG + C&L	M	M
Fortis	NA	NA	NA	KPMG	KPMG
Levob	Moret & Limperg	MEY	MEY	MEY	MEY
RABO	MEY	MEY	MEY	MEY	MEY
Reaal	NA	NA	KPMG	KPMG	KPMG
NMB	KPMG	M	M	M	M
NN	Moret & Limperg	MEY	MEY	M	M
Postbank	KPMG	M	M	M	M
NMB-Postbank	NA	KPMG	M	M	M
ING	NA	KPMG	KPMG	MEY	MEY

Table 3.4. The Auditors of Financial Conglomerates.

Source: Annual Reports and Reach.

M: merged C&L: Coopers and Lybrand (Belgium)

NA: not applicable NN: Nationale Nederlanden

*: Moret and Limperg is the predecessor of MEY

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