

AFM Agenda 2016-2018 – Supervision in times of change

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# AFM Agenda 2018



# The Dutch Authority for the Financial Markets

The AFM is committed to promoting fair and transparent financial markets.

As an independent market conduct authority, we contribute to a sustainable financial system and prosperity in the Netherlands.

# Foreword



The Dutch economy and the financial markets show a strong recovery. The economic growth, rapid digitisation, and new-entrant providers present opportunities for the markets as well as the financial consumers.

But alongside new opportunities, these developments bring new risks with them. Do companies handle data carefully enough? Is the quality of computerised advice adequate? Will the growth of passive investing entail new

stability risks for the financial markets? The persistently low interest rates also continue to pose risks. Pension funds and insurers have been feeling the effects of this for a long time, with the low rates weighing heavily on their coverage ratios and solvency status. We also see that the low rates of interest on savings make high-risk investments and higher debt burdens more appealing to consumers. That can sow the seeds of future problems.

Society also continues to suffer the effects of problems from the past, which will make some groups of consumers vulnerable to the future. For example, part of the Dutch population is accruing less pension than envisaged. Among customers with interest-only mortgages, a group has not yet repaid enough, thus running the risk of facing financial problems or large increases in their monthly outgoings.

As supervisor, we have to divide our attention between existing risks and new risks. Our goal is twofold: solve existing problems, and detect new risks before they cause major social problems. This is what we have concentrated on for several years. And we will continue to do so. We have reminded players on the financial markets of their responsibility to help vulnerable customers. For some of these customers, though, it means that they must also take action themselves to avoid future financial problems.

We also take a critical look at the deployment of new technologies and the use of data in selling products. While the use of new technologies and data presents opportunities, it also raises fundamental social questions. An example is the situation in which data on customer behaviour is a factor in whether or not to accept a customer, or in determining the price a customer should pay for a product. Personalised pricing of products can result in the exclusion of certain customer groups, or in misusing the consumer needs of vulnerable groups. The possibilities and risks that the cocktail of technology, data and consumer behaviour offers therefore places high demands on the duty of care financial companies shoulder. Moreover, issues revolving around technology, data and consumer behaviour are not unique to the financial sector. The implications of using big data, artificial intelligence and machine learning, for example, raise broad social questions. Such

questions, even those arising mainly in the financial sector, cannot be addressed or answered by the Dutch Authority for the Financial Markets (AFM) alone. To overcome this, the AFM is offering a platform in 2018, using its role to help set the agenda for the wide-ranging debate.

To rapidly identify and deal with future risks in our role as supervisor, we constantly invest in improving how we perform this task. One way is by utilising the findings from behavioural psychology. This puts us in a better position to judge whether companies are giving customers' interests a sufficiently central priority.

Technological advances and availability of data also provide opportunities to make our supervision more effective and with even more foresight. The next few years will be characterised by the further strengthening of our data position and analytical strengths, with the aim of becoming a supervisor that is increasingly data-driven.

In 2016, we published our Agenda 2016-2018. In this document, we set out our three strategic priorities: the market risks we see and deal with; how we further strengthen and redefine the supervision we conduct; and making our internal organisation more flexible. To perform our task effectively and credibly, we have to act both decisively and independently, as well as maintain the connection with our stakeholders. We accordingly discussed a draft of this Agenda 2018 with our advisory panel on 12 October. The final version here incorporates the panel's suggestions wherever possible.

Over the past few years, we have streamlined and simplified the structure of the organisation. Operations have been made more professional, with the activities bundled under the direction of a COO. With the strengthening and redefining of our supervisory work, we have taken significant steps towards expanding our professionalism, based on data-driven supervision, and setting up the Expertise Centre as a driver of innovation.

In 2018, we will unceasingly continue to invest in redefining our supervision, and in reinforcing the quality of the primary supervision. This is with the objective to keep identifying the relevant market risks, and dealing with them. For in times of economic growth, too, we as supervisor have to stay on guard.

On behalf of the Executive Board

Merel van Vroonhoven

*Chair*

# Management summary

Our world is changing at a rate of knots. This places high demands on our supervision and the sector we supervise.

In our Long-Term Agenda 2016-2018, we described the market risks we observe and how we deal with them, and how we further develop our supervision and strengthen our internal organisation. Our actions in this respect are based on a set of three priorities.

In this 2018 Agenda, we describe what this means for our activities in 2018.

This year, the AFM has identified three major trends that are producing risks for financial markets and financial consumers alike. Moreover, these three trends interact, thus increasing both the complexity and the risks of the financial playing field.

## *Growing digitisation*

Digitisation within the financial sector is expanding at great speed, leading to the development of new products and services, new distribution channels, and new providers. It is important that we make sure that these products and services are in the interests of the customer.

The expanding role of technology in the financial sector means at the same time that laws and regulations (European as well as Dutch) governing IT and privacy are becoming steadily more relevant. As a result, interaction and overlap with other supervisory bodies is more and more

common. A possible consequence is that risks arise that are not assigned to any supervisory jurisdiction, or it is not entirely clear to which one.

## *Low interest rates*

The low rates of interest have long affected the financial sector and the finances of consumers, with the solvency of life insurers and the coverage ratios of pensions being under pressure. It is more tempting for consumers and companies to take on a lot of debt or seek out high-risk investments with a better return.

## *The boundaries between financial markets are fading.*

Money flows, products, services and data in the financial sector increasingly often move freely across national borders, as well across the boundaries of the traditional sectors. More parties are offering their financial products and services from abroad.

In 2018, many new regulations will take effect in Europe (such as MIFID II and PSD 2). As a result, the emphasis in 2018 will shift away from drawing up new rules, towards implementing and enforcing them.

These three trends are influencing the way in which we define our priorities in detail. In this Agenda, we show how we are fleshing them out in 2018.

**Figure 1: Diagram of AFM's strategy, priorities and KPIs.**

# Mission & vision

The AFM is committed to promoting fair and transparent financial markets. As an independent market conduct authority, we contribute to a sustainable financial system and prosperity in the Netherlands.

By 2022, the AFM will be a proven, groundbreaking supervisor.

Priorities	Social objective
<b>1 Reducing undesirable risks in the financial markets</b>	<ul style="list-style-type: none"> <li>+ <i>Financial enterprises give central priority to the interests of their customers</i></li> <li>+ <i>Vulnerable consumers are protected against future problems</i></li> <li>+ <i>The AFM is a technology-driven and data-driven supervisor</i></li> <li>+ <i>Society can justifiably have confidence in the quality of financial reports and statutory audits</i></li> <li>+ <i>The capital markets function fairly and transparently</i></li> <li>+ <i>The financial sector is not misused for criminal activities</i></li> </ul>
<b>2 Strengthening and redefining our supervision</b>	<ul style="list-style-type: none"> <li>+ <i>The AFM is a technology-driven and data-driven supervisor</i></li> <li>+ <i>The AFM is a thought leader for the conduct-of-business supervision</i></li> </ul>
<b>3 Increasing the effectiveness, efficiency and flexibility of the organisation</b>	<ul style="list-style-type: none"> <li>+ <i>AFM carries out its supervision efficiently and effectively</i></li> </ul>
<b>Continuous Supervision</b>	<ul style="list-style-type: none"> <li>+ <i>The capital markets function fairly and transparently</i></li> <li>+ <i>Society can justifiably have confidence in the quality of financial reports and statutory audits.</i></li> </ul>
<b>Business operations</b>	<ul style="list-style-type: none"> <li>+ <i>AFM carries out its supervision efficiently and effectively</i></li> </ul>

## Priority 1: Reducing undesirable risks in the financial markets

The trends form the guide to identifying the top 10 risks. These are the ones we want to prevent from materialising, or whose adverse effects we want to mitigate.

These top 10 risks constitute a key parameter for the deployment of our supervisory capacity. Alongside tackling the

top risks, we carry out standard supervisory tasks, such as granting licences, evaluating directors, and approving prospectuses.

Compared with last year, most of the top 10 risks have remained unchanged or become slightly more serious. The two new entrants are the risk of insufficient focus on sustainability, and the risk of the financial sector being used unlawfully.

Two risks are no longer among the top 10. The risk of limiting vulnerability due to interest rates remaining low for long periods is still present as an underlying phenomenon, but is an integral part of each top 10 risk.

The risk represented by the legacy problems of insurers receives adequate attention as part of the AFM's ongoing supervision.

Some leading spearheads in our supervision as regards the top 10 risks for 2018 are:

#### *Risk of a loan not being in the interest of the customer*

Customers must be able to trust that loans match their needs and are in their interests. One thing that the AFM wants from providers of consumer credit is that they change their business practices to prevent locked-in situations from occurring, and resolve them if they do. A consumer is locked-in if he or she cannot move to another provider on account of, for instance, being overextended in terms of credit by current standards.

A current goal of the AFM is adherence to Uniform Herstellkader Rentederivaten MKB, a standard interest-rate derivative recovery framework for small and mid-size enterprises (SMEs). This goal includes SME customers receiving the compensation they are entitled to. As the implementation of the recovery framework is experiencing a delay, the AFM will continue to closely monitor the progress in 2018.

#### *Risks of unsuitable investment products*

Consumers might view investing as an attractive alternative to saving, one reason being the current low interest rates and the large number of investment products offered online. To improve the quality of investment products, the AFM is investigating the degree to which investment

firms are complying with the standards of MiFID-II for product development.

We also monitor the market. If we detect obviously harmful products, we invoke the MiFIR intervention powers to remove them from the market.

#### *Risk of unfavourable consequences for markets and supervision due to international developments*

We are doing all we can to make Brexit a smooth process for the financial markets, our objective being the prevention of undesirable effects for investors and consumers. We also want to prevent UK financial companies that want to move to continental Europe from having to deal with a different interpretation or application of European regulations depending on the national supervisor concerned. Accordingly, we are doing our best to bring about further convergence of supervision in Europe.

#### *Risk of unjustified use of technology and data*

The advancing digitisation means higher standards for the managed and integrated business activities of companies subject to supervision. In 2018, the supervision of operating process and ICT will become more intensive to check whether these standards are actually being met. As part of this supervision, the AFM will conduct thematic studies into cyber risks and the use of algorithms.

#### *Risk of inadequate improvement in the quality of statutory audits*

The AFM is encouraging some audit firms for public interest entities (PIEs) to systematically safeguard and apply improvements, in order to produce high-quality statutory audits over the long term. We are also intensifying our supervision of the other PIE audit firms by examining the quality of the statutory audits these firms conduct.

In the second half of 2018, we will also commence assessing the suitability of incumbent directors.

### *Risk of a disappointing post-retirement financial position*

More and more, consumers bear their own responsibility for having sufficient income during retirement. They must therefore be able to rely on a good match between the financial products they purchase to supplement their pensions, and their expectations and needs. For this reason, an analysis of these third-pillar pension products was conducted in 2018.

In dialogues with stakeholders, moreover, we encourage the perspective of pension plan members being sufficiently involved in the discussions on a new pensions system.

### *Risk of inadequate risk management by portfolio managers*

The portfolio management chain has to be equipped such that it can adequately respond to developments like changing regulations and the application of new technologies. Prompted by the regulations arising from MiFID II, we are conducting a study in 2018 into the extent to which the above parties have correctly implemented these regulations.

In 2018, there will also be a follow-up assessment of companies already active on the Dutch market and that have received a licence under AIFMD. We are testing whether they are in compliance with the relevant laws and regulations.

### *Risk that the operation of the capital markets fails to produce the best prices*

The AFM promotes the balancing of supply and demand for capital and risk in a fair and efficient manner. One way we do this is to press for further improvement in the functioning of the trading chain.

By way of example, we conduct focussed assessments across the market to check whether players in the trading chain adequately manage the risk of disruptions to trading. In 2018, the AFM, following the ESMA guidelines, is reviewing the resilience to cybercrime, for example.

In addition, the AFM will analyse the MiFID II and EMIR transaction data that is available, evaluate the quality of the data, and exchange information with other supervisors. The aim is to identify market abuse and potential destabilisation of the market in time.

### *Risk of inadequate focus on sustainability*

There is growing social attention to sustainability. On the financial markets, this is reflected in both the supply and demand for financial products and services with a sustainable character. These developments demand that the AFM's supervision gives particular attention to this theme. In 2018, we are identifying those financial products for the retail market that carry a sustainability label. This analysis will be the initial step in research to determine whether the information provided on these products truly matches their characteristics.

We will continue in 2018 to encourage the further application of integrated reporting, while advocating the creation of a uniform international standard.

### *Risk of the financial sector being used unlawfully*

The confidence in the financial sector is undermined if companies subject to supervision engage, deliberately or unknowingly, in financial-economic crime or in other unethical activities. Due to the greater opportunities resulting from the increasing digitisation of financial services, intensification of supervision is demanded.



We are identifying the risks for institutions subject to the FSA, and developing a long-term supervision strategy to match the risks. As part of these actions, one issue we pay attention to is the extent to which holders of AFM licences use virtual currencies. Action is taken against financial-economic crimes and unethical conduct, including shutting down the activities in question.

## Priority 2: Strengthening and redefining our supervision

The rapidly changing world of finance sets a high bar for supervision. To continue fulfilling our roles effectively in the future, we have to keep developing the methods we employ for supervision, as well as the tools we use. Based on our ambition to be a proven, groundbreaking supervisor, we have placed the emphasis for Agenda 2016-2018 on the development of data-driven supervision and the reinforcement of our set of research methods.

To ensure that our supervisory staff are even better equipped for their work in terms of knowledge and skills, we are going to expand our Supervision Academy in 2018.

Data and technology can be deployed to give early warnings about new risks and to enable the rapid detection of unusual behaviour on the financial markets. We are therefore taking the development of data-driven supervision a stage further this year. We are going to design new supervisory processes, or redesign existing ones with the aim of making them highly automated and more data-driven in their execution. In parallel, we are improving our information position so that we can more quickly pinpoint the risks that arise in the market.

As part of our Innovation & Fintech programme, we keep abreast of advances in financial technology, and keep up a dialogue with new entrants on new service concepts. At the same time, we try not to make the threshold for entering the market too high, while staying vigilant to verify that existing

and new providers act in the interests of the customer.

In 2018, we will continue expanding our knowledge on the decision behaviour of consumers. By utilising behavioural science, we gain more insight into why consumers make certain choices, including the associated influences on them. In this way, we can, for example, better assess whether financial service providers give sufficient central priority to the interests of customers.

## Priority 3: Increasing the effectiveness, efficiency and flexibility of the organisation

To react nimbly to the external challenges of the rapidly changing world around us, adaptation of our internal organisation remains essential. We place the emphasis in this regard on strengthening management, together with professionalism for operations and accountability. In addition, the AFM is increasing its focus on redefining our supervision. To devote more attention to this change assignment, we have chosen to enlarge the Executive Board. The challenge here is to be as flexible and versatile as possible within the confines of our limited budget.

Significant progress has been made over the past two years. To give an example, AFM Werkwijze was introduced, a work methodology based on short-cycle management and continual process improvements.

In 2018, management of our own organisation's risk and expenses is also a key issue, as is further optimisation of the operating processes. In addition, we are making the range of IT applications smarter and more versatile, so that we can work more efficiently.

### *Social objectives*

In this Agenda, we have set out the activities we are going to carry out, including the social objectives we are pursuing. As

supervisor, we certainly want to render account for the results of our efforts.

The social objectives are shown subdivided by priority in **Figure 1**. We have assigned key performance indicators (KPIs) to our objectives, and present them in the appendix. A review of our performance relating to them will be part of our annual report for 2018.

### *Finance*

The total budgeted for expenses in 2018 is virtually the same as the total budgeted for

2017 and equal to the cost framework for 2018. The size of the workforce is growing in 2018, mainly because of new activities arising from European legislation, the strengthening of our supervision, and additional investments for data-driven supervision. Offsetting these are savings on items such as accommodation expenses and operating activities.

### **Key figures (\* € 1 million)**

<b>Kerncijfers</b>	<b>Begroting 2017</b>	<b>Begroting 2018</b>	<b>Afw. tov B2017</b>	<b>Doorkijk 2019</b>	<b>Doorkijk 2020</b>	<b>Realisatie 2016</b>
Totale lasten	98,4	98,6	0%	98,8	98,9	90,1
Gemiddeld aantal fte's (incl. inhuur)	635	662	4%	648	641	603

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