

Digitalisation – disrupting force in the world of finance and financial supervision

Laura van Geest, Amsterdam FinTech Week, 16 September 2022



Introduction

Andy Warhol and the Pop Art movement were a disruptive force in the art world of the 1960s:

- Silk screen printing as an art technique
- A Campbell's Soup can as an object worth painting
- Cross-sectoral as a way of working – not just a visual artist, but also a producer of the well-known rock band Velvet Underground (with Lou Reed)
- Debunker of THE artist, using assistants to increase productivity
- Host at his studio: The Factory, a hot spot for creatives of all stripes, as well as 'underground' celebrities
- And perhaps best known for the 15-minutes quote: In the future, everyone will be world-famous for 15 minutes

The art world was never the same afterwards. You see where I am heading. Digitalisation is a disruptive force as well. With digitalisation, the economy will be transformed:

- New technologies develop and leave their mark
- New products and services spring to life from unexpected sources
- Existing products get an extreme makeover
- Production processes get revamped, distribution systems redesigned
- New players enter the market. Old players reinvent themselves, either under their own steam or by absorbing start-ups. Of course, some will be forced out of business and some start-ups will never make it. This is the brave new world of creative destruction.

The future is yours as you are sitting in this hall.

- Perhaps you are a start-up, hoping to become the next Amazon, Google or – closer to home – Adyen. To become a household name just like Andy Warhol.
- Perhaps you are an inventor, interested in creating new things but not so much in running a big company. Interested in your 15 minutes of fame – but quite willing to be absorbed by a bigger player.
- Or perhaps you are a well-established party on the lookout for new and interesting ideas that help you to stay in business: new products or smart reg-tech solutions.

I hope this Amsterdam FinTech Week was just as creative and inspiring as Andy Warhol's Factory, with lots of opportunities to look at the world in terms of potential, openings, chances, opportunities, possibilities.

And now you need to listen to a regulator like myself, generally cast in the role of – dare I say it – party pooper. Yes, we favour innovation, yes, we like progress and see the upside. But we are in the business of identifying risk. We are not naive. Financial well-being in the Netherlands, fair and transparent markets – the AFM purposes in life – are not ‘safe assets’ that take care of themselves.

Should these innovations in the world of financial services not be complemented by innovations in the regulatory world?

Digitalisation: trends and risks

How do I see the world develop? And what does this imply, for you as FinTech sector and for us as regulators? After all, we are in this together.

First, let’s start off with some trends:

1. Data makes the world go round
2. Network effects are strong
3. People love the products and services big tech provides
4. Firms love the cost savings big tech delivers
5. AI and DLT enhance efficiency and create new possibilities
6. Sectoral boundaries will be redrawn
7. National borders will disappear

More and more, financial services will be provided by data and IT enterprises.

- New parties will enter, established parties will transform into data and IT enterprises
- Digital distribution channels will be the norm, opening-up the market to the whole of EU consumers and b2b

This creates enormous opportunities for new and better products, targeted distribution- and cost savings. No doubt about it. But there are also risks. Let me mention a couple.

- Fair competition. Big tech has ample access to data through its online platforms. The more consumers and suppliers are linked to a certain platform, the more attractive it becomes. Strong network effects lead to winner-takes-all business models. This will pose problems for all of you. How do we prevent monopolistic behaviour and ensure fair pricing?
- DLT. Financial sector participants are interested in the opportunities of new technologies: smart contracts, more rapid settlements, opportunities to cut costs. Entirely new business models and companies will develop, partly outside the mandate of regulators. Think of the world of DeFi. Innovation is great, but financial stability and consumer protection are not innate to the financial system. The recent ‘crypto winter’ is a case in point.
- Outsourcing. Financial firms need to run their operations in a controlled and ethical manner. How do you make sure of this when you outsource more and more of your IT operations? How thorough are you in your outsourcing and contract management? And what about these providers themselves? Who supervises them? Not unimportant if you see no alternative but to migrate to the cloud.
- Privacy. There are rules to safeguard privacy (GDPR), but people quite often prioritise convenience over privacy and have no qualms about sharing their data. They do this without taking into account the repercussions for themselves and others. How do we ensure that privacy does not become a luxury that citizens on a tight budget can ill afford? Something to think about when you grumble about GDPR.

- **Solidarity.** With all these data and AI floating around, insurers will be better placed to assess risks and to price it accordingly. On the one hand, it is an effective feedback instrument and helps to contain moral hazards. It keeps insurance affordable. On the other hand, personalised pricing is a dead-end street as far as solidarity is concerned. If you are a bad risk, personalised pricing will mean higher and higher premiums that you simply cannot afford. And over time, as the pool shrinks, we all become a relatively bad risk. Dutch insurers work with an ethical code. But for how long will they continue doing so, as insurance transforms into an EU-wide market?
- **Crime.** Digitalisation may also lower the bar for crime. It becomes more anonymous, undertaken from afar. Think of cybercrime or mis-selling and fraud. Difficult to deal with, especially across borders. On the other hand, smart AI may provide an efficient means to assess risk and help to focus the deployment of scarce resources.

So what is the way forward?

As policymakers and regulators, we have to acknowledge that digitalisation is not an exercise in business as usual. Of tinkering at the margins. The transformation of the economy provides major benefits: lower costs and new products people love. We should not try and block this or try to drag us back to the dark ages before the internet, smart phones, AI and DLT. On the other hand, we cannot rest on our laurels and surrender the public values we all cherish to the new forces that be.

If the economy reinvents itself, we as policymakers and regulators must follow suit. A rethink is needed on how best to deliver on our mission. What does this mean in real life? More action at the EU level, more action outside the classical arena of financial regulators and more cooperation between regulators of all stripes. This does not necessarily mean more rules, by no means, but it does mean more coordination. Let me elaborate.

- The EU is the natural level to arrange things. Big tech needs to be made to listen and that is easier done at the EU level than locally. If you want to avoid supervisory arbitrage, EU legislation is warranted in a world of true cross-border operations.
- If a level playing field, network effects and abuse of monopolistic market power become an issue, competition policy is the logical remedy. First steps have been taken with the recent adoption of the DSA and DMA more may follow.
- Horizontal legislation across sectors is the tool to cover the use of data.
- Classical financial sector regulation has a role as well. As the crypto world intermingles more and more with the financial sector and consumers, consumer protection and financial stability achieve regulatory attention. As outsourcing of IT becomes the norm, rules to ensure the digital operational resilience of financial firms will be introduced.
- For you, this implies becoming familiar with the EU letter soup of DMA, DSA, DORA, MICAR etc. It also implies that you need to deal with more and different regulators than just AFM and DNB. Think of the Netherlands Authority for Consumers and Markets (ACM), the Dutch Data Protection Authority (AP) and European bodies like the European Commission, the European Supervisory Authorities (EBA, ESMA and EIOPA) and the *European* Data Protection Board (EDPB).

Working together: regulators and the sector

As regulators, we do not have all the answers. New territories imply new phenomena that we need to get to know. This is an argument in favour of an exploratory, collaborative approach as we feel our way forward. As Dutch regulators, we try to keep abreast of developments in the sector and are open to dialogue with parties that want to explore new avenues. This is important for various reasons.

- First, to ensure informed and useful legislation at the EU level. Legislation and supervisory convergence that really delivers.

- Second, to foster (or at least not needlessly harm) FinTech developments in the Netherlands. Hence the Innovation Hub that we run together with DNB. It provides you with support regarding queries you may have about supervision and regulations regarding innovative financial products and services you are considering. Our support is available to both new and existing firms, whether you ‘enjoy’ the role of AFM and DNB as regulators or not.
- A third reason to work together is the administrative burden associated with supervision. Firms need to comply with all these regulations. Regulators need to supervise. All these data and technologies also present new opportunities to deal with the unavoidable costs of supervision. Regulators plugging into the blockchain or into datasets as opposed to all these data transmissions? Supervisory tech and reg-tech provide interesting opportunities to get our goals aligned.

Conclusion

A regulator is not a happy camper by nature. However, I hope you get a sense that I think that digitalisation is not only inevitable, but also desirable – for consumers, business and even compliance officers and regulators. We just need to get the conditions right.

Digitalisation will leave its mark on the world. It is up to all of us to make sure that we will look back with a comparable awe and enthusiasm as on the heritage of Andy Warhol – be it the quote, his many artworks, his influence on the Velvet Underground or just the fact that modern art was forever changed.

In The Factory, people crashed on a red sofa, coming down after a night of hard partying and a trip on LSD. I do not know what the FinTech Week organisers have in store for you. Probably something more mundane, like drinks.

Thank you for your attention.



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