AFM Agenda for 2016-2018 – Supervision in times of change

AFM Agenda 2017

The Dutch Authority for the Financial Markets (AFM)

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.

Disclaimer

This is an English translation of the original Dutch text, furnished for convenience only. In the event of any conflict between this translation and the original Dutch text, the latter will prevail.

Contents

Foreword

Financial markets are changing rapidly as a result of social and technological developments. Although this creates new opportunities, it also poses risks to society. An important task of the Dutch Authority for the Financial Markets (AFM) is to identify these risks and limit these risks through targeted supervision. To do so well and reliably, we must act both decisively and autonomously while ensuring that our own organisation is well organised and that we do not lose sight of our stakeholders.

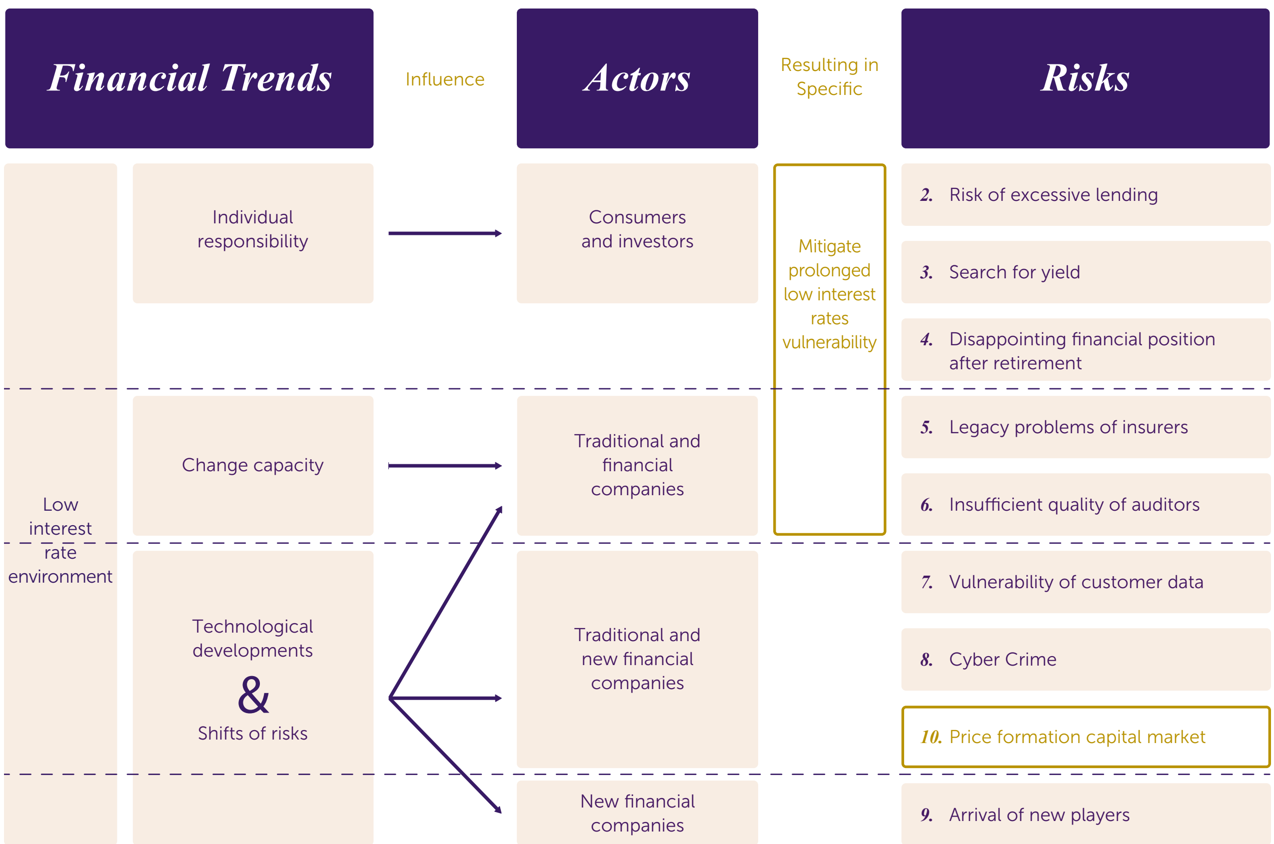
Insight into new and future risks is essential in this respect. That is why the AFM is investing in strengthening and renewing supervision and carries out risk analyses for the financial sector as a whole, but also for sub-sectors on an ongoing basis. This agenda is part of the 2016-2018 Agenda published previously and outlines AFM's supervision approach for 2017. This approach is based on the most important social and financial trends and top 10 risks.

On behalf of the Executive Board,

Merel van Vroonhoven,
Chair

Management summary

In our agenda for 2016-2018, we have outlined the major trends and risks in the financial markets and in society at large. We have selected ten risks that the AFM regards as the most important risks; our top ten risks. We reassessed these top risks for 2017 in view of the changing market conditions, taking into account in particular the low interest rate environment.



During the period 2016-2018 we will focus on three priorities:

Priority 1

Reducing undesirable risks in financial markets

In our plan for 2016-2018, we identified what we believe to be the top risks for society in the years ahead. Based on the current developments in society and in financial markets, we will constantly reassess these major risks and apply our supervisory capacity to deal with these risks. We define an approach for each risk and we subsequently translate this into specific tasks for each department. In addition, the AFM performs its regular supervisory duties such as licensing, assessments and the approval of prospectuses.

We have listed the key objectives of our supervision in 2017 below.

The AFM will be confronted with and will have to prepare for many new tasks in 2017. The most important of which is monitoring compliance with the MiFID II (Markets in Financial Instruments Directive). The objective of MiFID II is to increase the efficiency and transparency of European financial markets and to improve the protection of investors.

The AFM aims to ensure that actual pension benefits meet the expectations of pension scheme participants. This requires a comprehensive overview of income and assets on and prior to the date of retirement. Our focus will be on groups of people who run the risk of developing a pension shortfall, such as self-employed persons and divorced couples. In the debate over the system for the 'second pillar' pensions, the AFM advocates the interest of pension scheme participants. In this context, we examine the impact of aspects of a potential new pension system on the behaviour of participants.

Our efforts in the area of consumer credit aim to prevent excessive lending. As more and more loans are offered online, the AFM focuses on improving the online consumer credit decision-making environment. In addition, we continue our activities aimed at solving the 'interest-only' mortgage loan and consumer credit issues.

We also urge financial companies to encourage vulnerable households to reduce their debts and build up their assets. The aim is to achieve a significant reduction in 2017 of vulnerable borrowers with an interest-only or investment-linked mortgage loan.

The AFM monitors the correct application of the Uniforme Herstelkader voor Rentederivaten (Uniform Recovery Framework for Interest Rate Derivatives) by banks and external assessors. The AFM will report on the progress to the Minister of Finance at least twice a year.

Following the completion of the second follow-up assessment of Big 4 audit firms, the quality of audits performed by other firms will be assessed. Assuming that the Wet aanvullende maatregelen accountantsorganisaties (Act on Additional Measures for Audit Firms) will have been implemented by 1 July 2017, the AFM will also start to assess the suitability of policymakers in 2017.

The AFM will also guide asset management parties in the direction of permanently and adequately serving the interests of investors. We will also perform a broader analysis of the systematic risks of asset management activities in 2017.

The AFM will see to it that new and existing crowdfunding parties have the appropriate AFM licence. In the 2016 Legislative Letter, we advocated general requirements in the Dutch Financial Supervision Act (FSA, Wft). We also continue to develop our crowdfunding supervision strategy. We will build on insights obtained through research into consumer behaviour.

The Innovation & Fintech Programme Team will ensure that the AFM keeps up with innovation in the financial sector to the extent that this contributes to sustainable financial well-being in the Netherlands. To that end the InnovationHub of the AFM and the Dutch Central Bank (DNB) has been created to answer questions on regulation of market parties wishing to introduce innovative financial services or products to the market. We will also establish a 'regulatory sandbox' to accommodate and provide a tailored approach for innovation.

Priority 2

Strengthening and renewing supervision

The new Expertise Centre is the driving force behind methodological innovation within the AFM. In the Expertise Centre, we gather insights into human behaviour within the industry and of consumers. Those insights are used to make our supervision more effective and efficient. We are also investing in new systems that enable the analysis of large quantiles of market data to respond to social and technological changes in the financial markets. In this way, we are building a technology data-driven organisation.

Priority 3

Increasing effectiveness, efficiency and agility

In order to realise our ambitions, we are increasing our effectiveness, efficiency and agility. We aim to achieve this in 2017 as well by implementing our Strengthen and Renew change process. We have set three key objectives to that end:

+ We will strengthen our management by introducing short, cyclical management based on KPIs and by further developing leadership within the organisation.
+ We will professionalise our IT operations, processes and HR operations to improve our quality and efficiency.
+ We will render account to the outside world in respect of the effectiveness of our supervision and the choices that we make. The development of criteria to measure the performance of our organisation (Key Performance Indicators, 'KPIs') will also help us to further improve our accountability.

Financial framework

In 2017, we will invest in strengthening our foundation. This will enable us to perform new statutory duties and further develop the organisation. In addition, we aim to renew our supervision by additional investments in data-driven supervision, IT and the Innovation and FinTech Programme.

The total expenses budgeted for 2017 are 7% higher than in the 2016 budget and equal the cost framework for 2017. Subsequent years are expected to show a decrease.

Key figures (*EUR 1 million)

Key figures	Budget for 2016	2016 interim report	Budget for 2017	Variance in comparison to B2016	Prognosis 2018	Prognosis 2019	Realisation 2015
Total expenses	92.2	91.2	98.4	7%	98.3	98.0	86.6
Average number of FTEs (including external hires)	609	607	635	4%	632	627	607

1. Introduction

The ambition of the AFM is to become a ground-breaking supervisory authority by 2022. To realise our ambition, we are continually strengthening and renewing our supervision. How we intend to realise this up to 2018 is outlined in the 2016-2018 Agenda. Our supervision priorities have not changed compared to those in 2016. We have also set the following priorities for 2017:

1. Reducing undesirable risks in the financial markets through regular and thematic supervision.
2. Strengthening and renewing supervision through focused investment in technology and methodologies.
3. Increasing the effectiveness, efficiency and agility of the AFM's organisation.

The AFM will maintain this course in 2017. We will focus mainly on innovation and technological developments in the financial sector (fintech), the use and possibilities of data, capital markets and insights into consumer behaviour and the conduct and culture of financial companies. This agenda reflects the trends and risks that we observe. The Agenda for 2016-2018 remains largely unchanged, however we have sharpened our focus on a number of issues. We will outline developments in the area of legislation and provide insight into the international playing field in which we operate as a supervisory authority. We will explain our strategy and subsequently explain that our priorities in 2017 have been set based on external developments. The last section contains our budget for 2017.

02 External developments

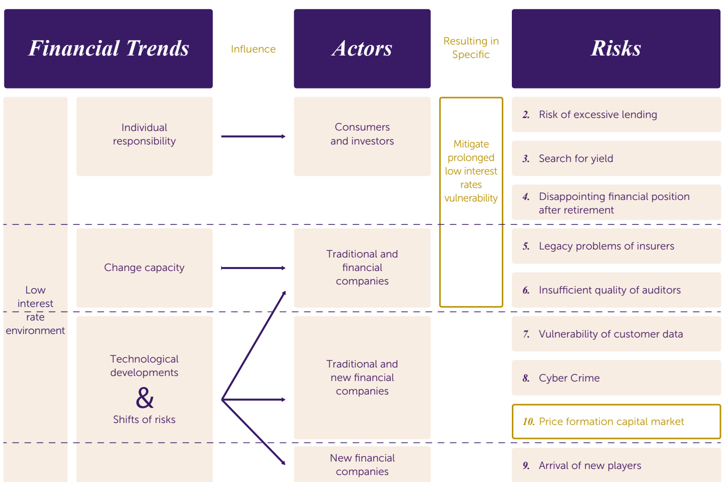
In our Agenda for 2016-2018, we outlined the major trends and risks in the financial markets and in society at large. In this section, we will outline the developments that we currently observe in the financial markets.

2. External developments

In our Agenda for 2016-2018, we outlined the major trends and risks in the financial markets and in society at large. In this section, we will outline the developments that we currently observe in the financial markets.

The trends are still the same as outlined in the Agenda for 2016-2018. However, we have defined our top risks more clearly. Ever-changing market conditions, in which the low interest rate environment features prominently, have made this necessary. In outlining those risks, we sometimes shifted our emphasis to reflect new insights and external developments. Some risks were combined due to their overlap. For example, the risk 'Arrival of new players' now includes the risks 'Poorer service due to fragmentation of the earning models of banks' and 'Arrival of new players leads to new (conduct) risks'. And the risk 'Search for yield' arose from 'Growth of asset management leads to new conduct and systematic risks' and 'Lack of proper consideration of risk-return trade-off'.

The low interest rate environment analysis is dealt with separately, focusing on specific risks. Other trends have not been elaborated separately in more detail. These will be addressed in the discussion of the various relevant risks. Price forming within the capital market has been added as an additional top risk.



View in large format

2.1 Trends

The four most important trends in society impacting the AFM's supervision
The AFM identifies the following trends in society that affect its supervision:

1. Technology and data are playing an increasingly important role
   Technology and data are playing an increasingly important role in society. This also applies to the financial markets. Algorithm trading is no longer an unusual phenomenon. In addition, new regulations such as EMIR and MiFIR mean that supervisors have an ever-increasing amount of data available. This requires substantial investments in IT infrastructure.

2. Supervision is becoming more international
   Many businesses operate internationally, and developments in the financial markets are not restricted by national borders. This obviously affects supervision. Relevant regulations already originate mainly from Brussels. Cooperation between supervisors will only increase in importance. The European supervisory framework calls for convergence between the various supervisors. Market parties are also calling for this.

3. High expectations with respect to supervision
   Society has high expectations of supervisory authorities. A supervisory authority is expected to prevent abuses. In many cases, people expect a supervisory authority to take responsibility for ensuring a risk-free society.
4. Support for supervision is no longer a given
   The financial crisis created social and political support for supervision of the financial markets, and also contributed to the willingness of market parties to change. As the memory of the crisis recedes and the economy improves, this support is waning. The perception that strict legislation is urgently needed has decreased, and in the United States we are seeing the first signs of deregulation. As a supervisory agency, we are increasingly conscious of the need to render account of the effectiveness of our actions, partly due to this development.

The top five financial trends in financial markets

The AFM has identified the following high impact trends in the financial markets:

1. The low interest rate environment has had a major impact on the financial markets and has an accelerating reinforcing effect on other trends.
   Low interest rates are forcing investors to look for other means of realising higher returns, known as the 'Search for yield'. This makes it more likely that they will take more risk than they should. Low bond yields are also pressuring the coverage ratios of pension funds and the solvency rates of life insurers.
2. There is a shift from a collective system to individual risk-bearing, which is increasing the importance of personal financial planning.
   Risks are shifting more and more from the collective to the individual. This already applies to self-employed persons without personnel, who are themselves responsible for saving for their pension, but it increasingly applies to consumers as well. The reduction in collective pension accrual means that consumers will increasingly have to take responsibility for their retirement planning.
3. Traditional parties are finding change to be a difficult process.
   Over the past years, traditional financial companies have made progress in terms of putting the customer's interests first in their organisations. However, we see that they struggle to permanently bring about a necessary change of conduct and culture. This continues to lead to minor and major incidents.
4. Technological developments are leading to the arrival of new players and are putting the earning models of traditional players under pressure.
   Technology creates opportunities for new players and makes new earning models possible. This exerts pressure on traditional parties. New parties are coming into existence, mainly because marketing and distribution channels are becoming less dependent on physical contact, time or location. Technological developments also mean that more services to customers can be provided by specialist parties. The use of data has become an important source of profitability for many parties.
5. The shift from financing provided by banks to raising funds on the market is transferring risks to the capital markets.
   The financing of businesses, and therefore the risks of this, are moving away from the banks to the capital markets. Capital is increasingly raised in public markets with tradable instruments, with bonds playing the most prominent role. This trend can also be observed on a smaller scale, for instance in crowdfunding and credit unions. Since the organisation of the capital markets is becoming more international, the shift from bank funding to market funding will also mean that the risks become more international in nature.

2.2 Risks

The ten most important risks

The trends we have outlined above could create specific risks for consumers, investors, financial companies or other stakeholders. The top ten risks that we have observed form the basis for our decisions on how to use our capacity. We have explored the risks in more depth during the past period. Those risks that arise from the low interest rate environment will now receive the attention they deserve within risk[1].
As a supervisory authority, we will look at those risks. That means that we will mainly focus on any adverse effects thereof. The various aspects outlined by us may offer opportunities as well, but in view of our role, we will pay less attention to those.

2.2.1 Mitigate vulnerabilities resulting from prolonged low interest rates

The past 50 years have not seen interest rates as low as they are now, and the interest rates are likely to stay this low. If that will indeed be the case, this particular situation bears a number of characteristics:

+ The low interest rates put pressure on the profitability and soundness of financial companies. Because:
  + Net interest income of banks may decrease if the interest rates stay low.
  + The solvency of pension funds and insurers will be adversely affected.
  + Returns on fixed-income investments are and will remain low if the interest rates stay low.
  + Business models based on guarantees in respect of long-term obligations will come under pressure as it will become increasingly difficult to deliver on those guarantees.
+ Consumers may not be able to build up the capital in their pension scheme or insurance contract that they are counting on.
+ Households and businesses may get used to a combination of high debts and low interest charges. This will make them more vulnerable to, for example, unexpected interest rate increases.
+ If consumers, financial companies and financial markets start searching for higher returns, they may underestimate current or future risks, such as an increase of the interest rate which may or may not be expected.
+ Low interest rates contribute to shifts towards financial structures increasingly based on market funding.
+ Low interest rates affect the valuation of financial instruments of businesses and the assumptions and projections on which these valuations are based must be critically reviewed by auditors during their audit in the coming years.

Advantages

Low interest rates make it attractive for consumers to repay or refinance their mortgage loan. This will be the case, for example, when the mortgage loan is an interest-only mortgage loan with a long fixed-rate period and a high interest rate. This positively affects the individual debt position as the debt is reduced or converted into a mortgage loan with a repayment schedule.

Disadvantages

+ For the purposes of determining the maximum purchase price and financing of real estate, consumers and their advisers will base their calculations of the monthly mortgage payments on low interest rates. Significantly higher purchase prices are not felt as a burden in terms of the monthly mortgage payment. However, it will be more difficult to ultimately repay the higher amounts of financing when the interest rates start to rise again.

+ Risks are being transferred from the financial sector to consumers. This is a consequence of a widespread social individualisation trend under which consumers carry more and more responsibility for their own financial planning (e.g. the phasing out of guaranteed products in the life insurance industry and the shift towards defined contribution products in the pension sector). But they are not taking sufficient action, especially not when it comes to their post-retirement financial planning. There is also a risk that households with excessive credit cannot sufficiently benefit from the low interest rates to reduce their debt and in doing so increase their financial resilience.
+ Products offered by financial companies, the rationale of which is based on the low interest rate environment, do not necessarily benefit consumers. Take for example guaranteed pension benefits that are extremely expensive in a low interest rate environment. It is also conceivable that banks will set a maximum amount of savings in savings accounts on which interest is still paid. In addition, low interest rates have a negative impact on defined contribution schemes.

2.2.2 Risk of excessive lending

We have observed several risks that encourage excessive lending.

General expectations are that lending will increase if interest rates are low. In practice, we see that this is indeed the case for mortgage loans, but not for the various forms of consumer credit. That this does not apply to all forms of consumer credit can perhaps be explained by the fact that credit providers cannot always charge low interest rates. The interest rate is still high for overdraft facilities and credit cards.
Moreover, consumers are influenced by the design of the decision-making environment for financial products, including credit. This environment can pave the way for excessive lending, but we have not yet observed that this is happening on a large scale.
Due to changes in society, the risk of excessive lending may increase as pressure on disposable income continues. For example, because of increased labour market flexibility, the number of self-employed persons will increase and the number of people holding a permanent job will decrease. At the same time, the cost of living will rise for many households. Rents will be higher and medical expenses, local taxes and charges will rise as well.
To a large extent, credit is currently not being repaid or repayment is limited. This is less the case for new loans than for existing loans. It is estimated that 35% of Dutch homeowners have an interest-only mortgage loan under which no capital is accumulated.

Not all payment arrears are reported to the BKR (Credit Registration Office). This is the care, for example, for late payment of student loans, taxes, rent, health insurance and utilities. These are therefore not taken into consideration upon the application for credit. Again, this can fuel excessive lending.
A shift is taking place from consumer credit to leasing and hire purchasing. Leasing and hire purchasing are not subject to the licence requirement for offering credit and therefore cannot be controlled by the AFM.
The legal requirements that apply to financial companies leave much room for their own interpretation. This may effectively limit supervision. Codes of conduct and standard amounts mostly offer guidance, but are not always binding requirements that should be complied with by financial companies.

2.2.3 Search for yield

Various groups are looking for higher returns due to the low interest rates.

Consumers

As interest rates are low, expectations are that consumers will invest their money in riskier investment categories. The low interest rates have a flywheel effect as well: because of the low interest rates the prices of assets have risen and, as a result, investing has become more attractive in the eyes of consumers. It cannot be ruled out that consumers consequently fail to adequately consider the risks-return trade-off. For example, they may choose to invest in assets that may have a high return but also carry a high-risk profile and have low liquidity.

In addition to the search for yield, prolonged low interest rates may also cause households and businesses to get used to the combination of high debts and low interest expenses. This may result in increased vulnerability to interest rate rises. If the interest rate rises again in the future, consumers and businesses may get into financial difficulties as a consequence of the higher interest charges.

Fund managers

The search for yield appears to lead to riskier fund strategies and products of fund managers. First, because fund managers tend to invest parts of their portfolio in investments that carry a higher risk and return profile to compensate for low returns on fixed-income securities, for example. Second, financial companies may use the demand for alternative products to offer more complex products that are not in the interest of the customer. Finally, the search for yield may make it more appealing to fund managers to use more leverage for fund investments.

Asset management is growing. Increased competition may lead to pressure on asset managers to reduce costs. Costs may, for example, be reduced by outsourcing duties to specialised parties. The AFM is often not able to supervise these service providers directly and, as a result, direct supervision of controlled business operations may be partially lost. In addition, several AIF managers have received a licence by operation of law, whereas the AFM has not assessed whether the licensing requirements have been met. This means that we do not yet know whether the AIFM population has made changes to their organisations to ensure compliance with the new requirements.

Capital markets

Capital markets have become very sensitive to monetary policy adjustments. These may trigger a drop in the prices of assets. This may specifically be the case when assets that are labelled as 'safe' are overvalued and extra sensitive to interest rate changes. As the other risks of high-risk assets are underestimated in comparison to assets that are less risky, there is a second overvaluation. Therefore, these assets are extremely vulnerable to a rise in interest rates. If the interest stays low for a longer period of time, investors must get used to lower returns, whereas even those expectations may be difficult to meet. The search for yield will eventually most likely result in price corrections in capital markets. The current market conditions are a good breeding ground for the next 'asset bubble': the phenomenon in which prices of assets rise sharply in a brief period of time without any demonstrable economic grounds. Whether this will really happen in the future is very hard to predict at this point in time. Furthermore, an increase in leverage may make the capital markets even more vulnerable to market shocks, as this intensifies the interconnectedness of the various capital market parties, including banks. As a result, the use of leverage may amplify a negative price correction and adversely affect general financial stability.

2.2.4 Disappointing financial position after retirement

Over the past year, the buffers of pension funds have shrunk as a consequence of an ageing population and low interest rates. Indexation has been missed out on and participants were faced with cutbacks. At the same time, employers are more often than not less able and less inclined to absorb the risks because of the already high costs. Nowadays these risks are often passed to the participant. This means that many people will receive lower than expected pension benefits. This also means that consumers are increasingly responsible for the financial planning of their old age. Consumers may easily experience a drop in income in their old age. A large group of consumers is not aware of this. They are also not aware of steps they can take to cope with this drop in income.

Many participants have no clear picture of their entitlements. Their pension entitlements often consist of a share in one or more group pension schemes the size of which may fluctuate, also due to factors that are difficult to understand for a participant. Quite often participants are not actively involved in their pension, which is another problem. The perception is that it is too complex and that they cannot exert any influence anyway.

Participants also lack a complete overview of the income they can expect after retirement. It is precisely such an overview however that would help to assess to what extent income is certain or still uncertain by that time. Financial ambitions can thus be adjusted. The state pension (AOW), pension accrual during various employments within the second pillar, third pillar pensions, net savings ('fourth pillar') and the net property value ('fifth pillar'), taken together, determine the financial position after retirement.

2.2.5 Legacy problems of insurers

These are turbulent times for insurers. On the one hand, they are working on solving legacy issues from the past, such as investment-linked insurance problems and outdated IT systems. Not only do this result in high costs, this also makes it difficult to adapt products and to provide the correct information to the customer. On the other hand, low interest rates put pressure on the business model of insurers. Moreover, technological developments make a fundamental reorientation of insurance and the responsibility of insurers necessary. The introduction of new products and services represent opportunities as well as threats to consumers. All these developments give rise to many questions and uncertainty. What form should the duty of care take in a digital world? And how should organisations observe this duty of care? Other issues include customer data protection and protection of privacy. Also, what are the consequences for the principle of solidarity? And, relevant for the position of the insurer in the distribution chain, how will consumers seek advice and purchase financial products in the future?

2.2.6 Insufficient quality of auditors

Essential preconditions for an effectively functioning financial system are reliable financial reporting and an objective opinion of the auditor on this. The auditor plays a key role here in the financial system. For example, whether the annual report of a company gives a true and fair view of reality. The audit sector should mainly serve the public interest and not merely the interest of the companies that they audit. This demands high standards of audit firms and of supervision thereof by the AFM, comparable to the high demands placed on system banks.

In recent years, initiatives have been developed to improve the quality of statutory audits of audit firms. They definitely have had an effect, but further steps can certainly be taken. Improving quality requires an enormous effort from audit firms in the years to come.

Looking to the future, it seems that most trends and developments affecting the audit profession do not have a positive influence on the quality of the audits. The main reason for this is that many of the wrong incentives in the audit profession have not yet been eliminated, despite the reforms that have been implemented in the last few years. Perhaps the financing structure is one of these incentives as auditors are paid by the companies that they audit and the contradictory commercial interest to maximise the profit and the public interest, namely the best possible audit quality. Finally, the quality of the statutory audit performed is not visible to the user. As a result, the user cannot verify the accuracy of the findings of the auditor. Therefore, the efforts made by the audit sector as a whole and the role of the AFM as the independent external supervisory authority are of key importance. The year 2016 has shown that there is still a lack of understanding of the necessity and view of the role of the auditor, both within and outside of the audit profession. Against this backdrop it is all the more important that the main change agents stay firm and do not relax the efforts being made.

2.2.7 Vulnerability of customer data

Financial companies are in the possession of an ever-increasing amount of customer data and ever-smarter technology making it possible to use this data. Data-driven earning models are more often used by existing parties than by new parties. The use of data benefits both consumers and supervisors, for example, in the area of insights into customer behaviour, cost reduction, detection of fraud and money laundering. Possible risks include:

+ Profiling of customers may result in product pushing and miss-selling. Data may be used to create a customer profile and match the services offered to that profile (profiling). The creation of a customer profile that is too limited, inaccurate or not up-to-date may result in exclusion of customers or less choice for the customer resulting in his or her decision being influenced.
+ The privacy of customers may be violated because customer data is used for other purposes without the customer's permission. Data are very valuable to market players. Quite often, consumers lack full insight into the use of their data by service providers. There is a risk that data are used in a way that has not been agreed with the customer.
+ Customers who wish to share less or no data may receive poorer conditions or be excluded from receiving services. The provision of certain data may result in premium reductions, for example. Another example is that certain services

are or have become accessible in digital format only after certain information has been provided. This may result in exclusion.

2.2.8 Cyber Crime

Digital crime (cyber crime) is rising every year and is becoming more and more sophisticated. After theft and fraud, cyber crime is the most common form of economic crime. The role that technology plays in the financial sector is growing, as is the level of interconnectedness. As financial products and services are sold more and more online, there is a greater risk of cyber crime in the financial sector.

Cyber crime may affect both consumers and financial companies in a variety of ways. The financial sector may suffer losses, for example, because of theft of customer data through, for instance, skimming or phishing, or through abuse of vulnerabilities in outsourcing processes. Other examples include disruption of trading and/or payment systems, blocking access to services through Distributed Denial of Service (DDoS) attacks, for example, theft of price-sensitive information and confusion about the responsibility of customers and the responsibility towards customers. New forms of cyber crime challenge financial companies to tighten their methods. Not only must security be in order, the ability to recover and resume operations after a successful cyber attack is just as important. That helps to limit damage to the extent possible and to resume services as quickly as possible. There is a risk that companies, depending on their available expertise, change capacity and risk perception, for example, are not able to take the necessary measures in time.

2.2.9 Arrival of new players

Digitalisation

Digitalisation is an important theme for service provision to both new and existing parties in the sector. Think for example of cloud computing applications, blockchain initiatives, (big) data analyses, machine learning (A.I.) and online marketing. Some good opportunities to improve services can be found here. At the same time, we also observe new behavioural risks and the increase of existing risks.

Duty of care

Digital provision of services changes the contact with the customer and the way in which the provider handles its duty of care. Providing advice or asset management services no longer involves just one party, but a combination of software, hardware and data suppliers. It has become a 'supply chain responsibility'. Nowadays, new and existing players often outsource critical processes in the creation of their financial products or provision of services to third parties. The question is whether the procurer of those services has sufficient knowledge of the quality of the services procured, and whether the provider of these services also controls these services and is reliable. As third parties are not supervised by us, the AFM cannot monitor this.

Steering

The way in which consumers see information influences the choices they make. Digitalisation comes with many options. Think for example of the number of alternatives on offer, standard options, preferences, wording and design. Market parties may make clever use hereof, both positively and negatively. This is seen in environments such as online gambling environments: accessible to anyone with a smart phone, large-scale ease of access and low thresholds to suffer large losses and costs that lower the average returns. Credit providers may also make use of negative steering and thus possibly encourage irresponsible borrowing. Tools such as 'anchors' and standard options upon entering into a purchase financing arrangement (for example, a high credit or a long repayment period as the starting point) or less clearly visible presentation of the total credit amount. This increases the risk of irresponsible borrowing.

Fragmentation of earning model

For banks, the entry of new players means more competition which puts pressure on their earning model (dis-intermediation). In the Agenda for 2016-2018, this risk was described as 'Fragmentation of banks' earning models'.
Banks especially feel the pressure of dis=intermediation when it comes to lending duet to the rise of innovative alternatives. The main initiatives in this area include crowdfunding of smaller companies or consumers and alternative credit provision by professional investors. These initiatives offer opportunities for consumers in terms of better access to credit and more investment opportunities for investors. However, they pose risks as quality and creditworthiness of investment projects may differ greatly, as is the case for platforms used and to what extent investors are informed about the risks.

Alternative credit provision

The rise of alternative credit provision by professional investors is a relatively new development. Due to the low interest rates and the low risk of mortgages, the Dutch mortgage market has become an attractive alternative to government bonds for investors. Investors such as insurers, pension funds and foreign investors invest directly in loans, mainly mortgage loans, through the use of legal constructions. An issuing institution acts at the link between the consumer and the investor. Two major risks are associated with this:

+ Customers who are funded by investors may run into problems during the term of the loan, for example, when they refinance their mortgage loan. There is a chance that investors are no longer interested in this form of relatively safe investment in the medium term when most of the fixed-rate period has passed. Contrary to traditional credit providers, they run little to no reputation risk. There is a risk that the alternative mortgage lender would like to rid itself of a consumer by offering an interest rate that is much higher than the market rate of interest or offering poorer conditions in the renewal offer. Also, when a customer is faced with payment difficulties, an investor has less of an interest to be lenient towards the customer.
+ When banks and alternative credit providers collaborate, it is not always clear to the customer or others who has the duty of care, for example, in the case of mortgage loans. Consumers may be inconvenienced by it as it may result in a product that is not suitable for them. Also they may not know whom to turn to should they have questions or problems.

2.2.10 Price formation capital market

The role of stock exchanges has drastically changed due to globalisation and technological developments. Technological developments could, for example, lead to more accessible financial markets. Nowadays, traders can place orders on multiple trading platforms across the world. A disadvantage of this is that this could lead to fragmentation of trading and, consequently, less transparent price formation. The introduction of MiFID II and EMIR can possibly solve this by stricter pre-trade and post-trade transparency stipulations.

The best price is no longer a given

Prices of financial instruments are neither set efficiently nor transparently, and institutional investors consequently do not end up paying the best price. Therefore, smaller investors can also not rely on being offered the best price by their broker.

+ First, there is the constant risk that prices have not been arrived at in a honest and fair manner. Due to the high degree of interconnectedness of the various markets, there are sufficient opportunities for conduct lacking integrity that is hard to detect.
+ Second, price formation in financial markets may not always be organised in such a way that results in the best price, which presents a risk. Think of increased competition between trading platforms which has resulted in lower costs, but also in fragmented liquidity.
+ Third, there is a risk that some groups of investors do not have access to the best prices. A large number of platforms, particularly those in London, are organised as clubs only to be entered by a select group of brokers and customers.
+ Fourth, there is a risk that investors do not get the best price from their brokers. Brokers are obliged to offer 'best execution'. In the current fragmented world, many investors have a hard time determining whether they actually received this. This poses an even greater challenge for instruments other than shares. True 'best execution' is most certainly not yet a reality. Subject to the consent of investors, brokers by default may go through one or only a few platforms for their transactions.

Electronic trading makes high demands on the robustness of the trading infrastructure. Trading in shares is virtually fully electronic. Bond trading and trading in derivatives increasingly also takes place electronically. Moreover trade in financial instruments is fragmented across various platforms and countries.

The growth of the primary bond market gives rise to the concern that the liquidity on secondary markets will quickly evaporate, causing greater price shocks that give rise to another concern over whether or not the structure of the secondary market will be able to withstand prolonged periods of stress going forward. Unexpected interest rate increases may cause a steep drop in bond prices. In this situation, with low market liquidity on the secondary market, it may distort demand and supply and, consequently, efficient bond price formation.

Impact of monetary policy on financial markets

The combination of the expansionary monetary policy, low interest rate environment and investors looking for higher returns also affects efficient price formation of assets in financial markets. The relationship between risk, returns and costs may be disrupted, for example. The individual elements underlying the development of the value of securities are fading into the background.

Market players in the capital markets will obviously anticipate interventions or policy changes of central banks, for the most part, which may lead to homogeneous behaviour in the capital markets. Beside the effect of the current monetary policy, homogeneity may also be a herd reflex: concentration of ownership in the hands of a limited number of investors or tracking a benchmark (passive investment behaviour) by an ever-growing part of the market.

Homogeneity in European financial markets seems to have grown in recent years and may impede the efficient operation of financial markets. The apparent calm may result in anything from a less efficient allocation of means to sharp market price corrections and high volatility.
This development is therefore an important issue in international forums and is recognised by the Financial Stability Committee[2] in The Netherlands.

New supervisory duties

Regulatory changes and changed market conditions call for an expansion of supervisory duties and changes in the current supervision approach. The introduction of new rules and regulations affecting capital markets (EMIR, CSDR, SFTR, MiFID II and MAR) allow supervisors access to more data and expands the scope of their supervision. MiFID II, for example, places new market parties under supervision whereas before they were not subject to legal or other requirements. After the financial crisis, new rules and regulations, including Basel III and CRD IV for banks and Solvency II for insurers, were introduced to ensure the financial health of banks and insurers.

[1] Homogeneity in financial markets is the convergence of investment decisions. That means that a substantial number of investors respond to market developments in the same way.

[2] The Financial Stability Committee's task is to identify threats to financial stability in the Netherlands and to make recommendations about this. The Committee is composed of representatives of the DNB, AFM and the Ministry of Finance.

2.3 International policy and legislative developments

The supervision of financial markets is becoming more and more international. Many businesses operate internationally, and developments in the financial markets are not restricted by national borders. To a large degree, the control framework of the AFM is determined by international legislation and standards and the European supervisory framework requires increased cooperation and coordination between the various supervisors. Several international developments will have an effect on the policy-related activities of the AFM in and after 2017.

The legislative agenda of Brussels continues, specifically as far as the Capital Markets Union initiative is concerned

The plans of the European Commission to create a Capital Markets Union by 2019 gave birth to a series of new initiatives in the area of financial markets, categorised under the objective 'Jobs, Growth & Investment', that are to be realised in the next few years. These initiatives focus on the removal of unnecessary hurdles to cross-border provision of services, review of current rules and regulations and targeted adjustments. Although the Commission will present initiatives that are less far-reaching than preceding projects, such as the revision of MiFID and the adoption of EMIR, the legislative agenda concerning financial markets will still demand the attention of the AFM in the next years.

Extensive harmonisation of rules and regulations and supervision poses opportunities and risks for the AFM

Harmonisation of rules and regulations by the European Union facilitates the further internationalisation of financial markets. This means, for example, that businesses can serve all of the European market on the basis of a passport.
Home-host stipulations in specific regulations determine the responsibilities and powers of the various national supervisors. However, a rise in the cross-border provision of services may also pose additional risks, such as supervisory arbitrage.

The extensive legislative agenda in the European Union of the past years was characterised by a gradual trend towards maximum harmonisation and directly coming into effect. This high level of harmonisation means, in line with the objective thereof, that policy latitude is curbed when it comes to national rules and regulations, and that there is less scope to make and interpret further rules as one sees fit. Expectations are that the next-generation legislation will again result in further harmonisation through (self-executing) Regulations instead of Directives requiring conversion into national legislation.

In the years to come, Europe will focus on consistent implementation and application of rules by national supervisors and in doing so will improve the quality of the supervision across the EU. In the area of 'supervisory convergence' there is much to gain for the European Union and the Netherlands; it is befitting of the effort to create a EU capital market, a level playing field for financial companies and adequate protection of investors to have a regulatory framework that is applied consistently by the various supervisors.

However, convergence of supervision may also pose risks for the AFM. A strong call for supervisory convergence may end up in a 'one-size-fits-all' approach for all supervision in the EU without taking specific market conditions or a certain supervision culture into account. Increased standardisation of supervision and improvement of the average quality of supervision across the board in the EU carries the risk that the relatively high quality of Dutch supervision is reduced. As with legislation, there is a risk that instruments such as guidelines further restrict the existing scope for policymaking at a national level and for a more 'principle-based' approach.

Global forums increasingly determine the agenda and standards

Global forums such as the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) are more and more setting the tone and have become a first point of contact when it comes to placing global problems on the agenda and laying down policy principles in standards. A powerful illustration of this is the FSB, the Financial Economic advisory body of the G20, which has attained a leading position in a very short period of time. Another example is the setting of benchmark standards by IOSCO: the standards have had a wide reach and have left their mark on the rules and regulations drafted for Europe. The Financial Market Infrastructure Principles also serve as a guideline for national/regional rules and regulations. It is striking that these standards are becoming more and more comprehensive on a global level as well. No doubt, this will take away some room to manoeuvre at a national level in respect of additional requirements. The increased relevance of these global discussions and initiatives for Dutch supervision calls for the AFM's active participation in these forums.

European authorities are maturing and are receiving more powers

As financial markets within the European Union are integrating further, the role of the European supervisors (ESAs) is also becoming more important. The powers of ESAs are gradually increasing. Take, for example the European Securities and Markets Authority (ESMA) that, in addition to the supervision of credit rating agencies, supervises Trade Repositories and participation in CCP-colleges and has the power to ban certain products under certain conditions in the future. In addition, the ESMA encourages and facilitates cooperation at the European level. Examples include delegation of tasks to ESMA in respect of the development of IT systems, negotiation on Memoranda of Understanding, 'MoUs' with non-EU countries on behalf of the participants and the close cooperation in respect of aggressive providers of CfDs and binary options. For third countries, ESMA has already become the first point of contact for getting in touch with EU supervisors. As a result, ESMA will play an even more central role and may become indispensable to the entire supervisory system. The AFM considers this a positive development. It helps to create a level playing field for supervision of capital markets and it strengthens the protection of investors. As a result, cooperation with ESMA is vital to exerting influence on the direction of European supervision and rules and regulations. In addition, the involvement in ESMA is important for accessing and maintaining relationships with other supervisors and information on new developments early on.

Macro-prudential focus on capital markets
Over the past years, the focus of macro-prudential supervisors and central bankers on financial stability has been extended to include more capital market-related topics. The FSB, from a policy-related point of view, increasingly concerns itself with stability issues including in the area of asset management and derivatives. In addition, the ECB plays an important role in the supervision of CCPs and the European Systemic Risk Board (ESRB) monitors market illiquidity. This involvement is logical and desirable in view of financial stability risks in capital markets and the interconnectedness with financial companies, for example. This development emphasises the importance of good cooperation and coordination between macro-prudential and market supervisors.

Brexit
The imminent exit of the United Kingdom from the European Union has a major impact on the international environment and the activities of the AFM. It is difficult to predict the actual impact of Brexit. This is especially the case now that the future form of cooperation between the United Kingdom and the European Union is not yet clear. What is clear is that ESMA will lose one of its most important participants and the AFM will lose an ally. This causes the AFM to seek more influence on vital issues within ESMA and to invest in its relationship with the most active participants.
The AFM is open to the possibility of companies from the United Kingdom that may want to take up domicile in the Netherlands in the future. These companies must, of course, comply with the same requirements as companies already domiciled in the Netherlands.

2.4 Organisational risks

The AFM has identified the following potential risks associated with its own business operations. These risks are elaborated in more detail in Appendix 1.

+ There is an expectation gap between the role and effectiveness of supervision, causing a lack of public support for supervision by the AFM (licence to operate/mandate).
+ As we must set clear priorities within our wide range of tasks, there is a risk that we cannot pay sufficient attention to risks in the market in the performance of our supervisory duties.
+ The quality and functionality of IT systems offer insufficient support in the performance of our supervision.
+ The desired level of security has not been achieved. Moreover, our employees are not always sufficiently aware of the risks.
+ Insufficient knowledge retention, recruitment and advancement of staff in a recovering market and in the process of transitioning into a more data-driven supervisor.
+ Insufficient focus on effectiveness and agility of the internal organisation.
+ Lack of knowledge, experience and capacity of AFM in view of our comprehensive statutory duties.

03 Our priorities and related activities

The AFM is committed to promoting fair and transparent financial markets and contributes to sustainable financial prosperity in the Netherlands.

3. Our priorities and related activities

The AFM is committed to promoting fair and transparent financial markets and contributes to sustainable financial prosperity in the Netherlands. The AFM aims to be a demonstrably ground-breaking supervisory authority through effective and innovative supervisory interventions.

Mission

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.

An Ambitious Objective

We aim to be a demonstrably ground-breaking supervisory authority in 2022

Core values

Diligence & Thoroughness
Autonomy &
Connectedness

Core qualities

Discipline
Analytical Strength
Progressiveness

We have translated the 2016-2018 Agenda into an Activity Calender that is centred around 13 themes that we will work on to demonstrably become a ground-breaking supervisory authority by 2022. The themes have either an external (society or supervision related) perspective or an internal (employee/management or process related) perspective. The themes are classified into four 'maturity levels' with specific Key Performance Indicators (KPIs). The 2016 stakeholder and employee surveys give the AFM a first indication of where we stand in terms of achieving our ambitions. Starting in 2017, progress on maturity levels will be monitored so that elements can be adjusted.

Taking this objective as a starting point, we will focus on our three priorities. These priorities are the same in 2017 as they were in 2016, namely:

+ Priority 1: Reducing undesirable risks
+ Priority 2: Strengthening supervision
+ Priority 3: Increasing effectiveness, efficiency and agility

In this section, we will explain what we are going to do for each priority. First, we will address our activities to reduce the top risks (priority 1). For each risk, we will outline what we are going to do followed by a specification of the work for each supervisory division. We will also briefly describe our ongoing activities. The 2017 Activity Calender presents an overview of the specific activities.
For priority 2, we will explain how we will further strengthen our supervision through technology and methodology. To this end, we established an Expertise Centre in 2016. We will explain in which way the various subdivisions of this Expertise Centre are going to contribute to our objective.

Finally, we will explain how we will boost our effectiveness, efficiency and agility (priority 3). In order to achieve this, we are developing our internal organisation and improving our processes.

3.1. Priority 1: Reducing undesirable risks in the financial markets through regular and thematic supervision

New laws and regulations

In 2017, the AFM will be confronted with and must prepare for many new tasks, including monitoring compliance with the MiFID II Directive as the most important one. MiFID II (Markets in Financial Instruments Directive) comes into force in 2018. It is a revision of the European MiFID Directive which was introduced in 2007. The objective of MiFID II is to increase the efficiency and transparency of European financial markets and to improve the protection of investors. MiFID II changes certain rules that apply to investment firms and trading platforms.

Supervision of compliance with laws and regulations requires a thorough analysis of risks that we see in the financial world and the mitigation of these risks. Below we will specify for each top risk that we have identified how the AFM intends to generally reduce this risk. We will subsequently outline the resulting specific activities for each division.

Mitigate prolonged low interest rates vulnerability

Generally speaking, the AFM aims to achieve two effects when reducing the risks caused by low interest rates. First, the AFM wants to have the proper incentives in place allowing consumers to adequately plan their finances. In practice, this means that the AFM will actively urge financial companies to encourage vulnerable parties to reduce their debts and accrue capital. This mainly concerns vulnerable lenders with interest-only or investment-linked mortgage loans but also SMEs. In addition, the AFM aims to ensure that the expectations of pension scheme participants are fully in line with their actual pension benefits. Not only does this require realistic and clear pension communications, but very likely a structural adjustment of the pension system as well. In addition, the AFM will focus on the responsible provision of credit services by financial companies by demanding that they continue to put the customer's interests first and comply with the duty of care. To achieve this, the AFM will, for instance, encourage financial companies to offer products that keep their value in a high interest rate environment. The AFM also seeks to keep parties with unfair earning models out of the market.

Risk of excessive lending

As consumer credit is still potentially a major source of excessive lending, the AFM is reviewing the composition of the group of vulnerable consumers with consumer credit. We will also produce an overview of the market landscape of consumer credit that includes the amount of outstanding loans that are currently not or only partially being repaid. We will continue our activities aimed at solving the 'interest-only' loan issues. We will also formulate an integral supervision strategy for consumer credit aimed at discouraging excessive lending. As more and more loans are offered online, the AFM will specifically focus on improvements to the online decision-making environment for consumer credit.

Search for yield

The low interest rate environment may lead to the pursuit of higher returns. However, the question remains whether a good assessment is then made of the risks and returns. It is not easy to identify in which way investors search for yields. The AFM closely monitors the potential risks. If and when necessary, we will intervene. In this way, the AFM closely monitors the marketing conduct of investment service providers, the development of new high-risk investment products and the role in this development of possibly dishonest market parties.

Disappointing financial position after retirement

The AFM, as the market conduct authority for the pension sector, plays an important role in the debate on the new pension system. The interest of the consumer has our explicit attention in this debate. We are looking into which the preconditions a new pension system should ideally satisfy, as seen from the point of view of the participant. In addition, we want pension communications to be clear, and we specifically strive for consumers to have an integral overview of their income and assets on and before their retirement date. In the event of a decrease in income, it must be clear what actions are available to consumers to handle such a decrease. We will also see to it that pension products are in line with the needs of the consumer.

Legacy problems of insurers

Due to legacy problems, challenging market conditions, but also technological developments, players in the distribution chain of insurance products (such as insurers, advisers, intermediaries and proxy parties) are facing huge challenges. The AFM will assess whether and to what extent these players are future-proof. Based on the outcomes of this assessment, the AFM will develop and subsequently implement a supervision of conduct strategy.

Insufficient quality of auditors

We support a structural approach in respect of reform measures already imposed on audit firms. Our focus will be on the conduct and culture of audit firms. Given the speed with which the profession is changing, we will determine whether and, if so, what further reforms are necessary to improve the quality of audits. In research involving the Big 4 audit firms, we are examining any incentives that might influence new external auditors.

Vulnerability of customer data

The growing importance of customer data use in financial service provision increases the risk of abuse. Together with the Dutch Data Protection Authority (Autoriteit Persoonsgegevens), 'Dutch DPA', the AFM is developing a view for the prudent use and supervision of customer data. In addition, we monitor the use and abuse of customer data and encourage appropriate service provision on the basis of customer data.

Cyber Crime

The AFM participates in the Cyber Crime task force under the Euronext College of Regulators. In addition, the AFM is analysing what the potential cyber risks are of trading platforms and new payment service providers. Also, we are further investigating the risks of unauthorised access to the online environment that clients use for their transactions at (in-house) securities investment systems and custodian banks.

Arrival of new players

The AFM is preparing their view on how the duty of care should be implemented in a digital environment, with the aim that financial companies will internalise this view in their service provision. The same applies for our view on controlled business operations at financial service providers, investment firms and investment institutions. Also, we are completing our supervision strategy on undesirable fintech and other developments in the investment area. The InnovationHub continues to be an important resource in this respect as it allows us to discuss supervision issues with fintechs and innovative market parties. Where necessary, we will provide guidance to them. Finally, we will use scientific insights into online enticements techniques to tighten our supervision strategy for consumer credit.

We also continue to develop our crowd-funding supervision strategy. We will build on insights obtained through research into consumer behaviour. We will develop a strategy for identifying and reducing risks associated with alternative credit providers.

Price formation capital market

Our supervisory activities to ensure fair and efficient capital markets will be extended as a consequence of new laws and regulations. We will deploy data-driven risk analysis and pay close attention to new market segments. We use quantitative insights into the trading conduct of companies to quickly respond to risky behaviour. The AFM sees to it that trade in all financial instruments is controlled, and that parties in the chain take adequate measures to guarantee a robust trade infrastructure. In addition, we encourage efficient and transparent price formation that ensures that institutional investors pay the best price for financial instruments and, consequently, that smaller investors can rely on being offered the best price by their broker as well.

The organisation of supervision

The AFM has divided its supervision of market segments into various supervisory divisions . These supervisory divisions receive support from the Expertise Centre (see priority 2). In addition, the Innovation and Fintech Programme was started in 2016. In the next paragraphs, we will explain the activities for AFM's various supervisory divisions resulting from our approach.

3.1.1 Insurance and Pensions Supervision Division (I&P)

The Insurance and Pensions Supervision Division (I&P) employs three teams. Two teams focus on specific market segments; one team focuses on 'Pensions' and the other on 'Insurance and Advisers & Intermediaries'.

There is a cross-divisional 'Products and Services Monitor' team that focuses on information position and analysis generation on behalf of the I&P Division and the Lending, Saving and Retail Investment Supervision Division (LSR). In 2017, this team will perform a number of surveys and more in-depth analyses. To reduce the **'Low interest rate environment'** risk, the team is identifying high-impact products that are unsuited for the current low interest rate environment or that insufficiently account for possible interest rate rises. The aim is to prevent financial companies from offering products that do not meet the CUSC (cost-efficient, useful, safe and comprehensible) criteria and therefore are not suitable for consumers. To lower the **'Search for yields'** risk, I&P is charting the extent to which the market is moving in the direction of (new) high-risk products and services and what risks and opportunities are associated with this. To reduce risks associated with the **'Arrival of new players'**, I&P is generating insights into the scope and developments in the market for alternative credit providers. Based on these insights, we will determine a strategy to recognise and reduce risks in respect of alternative credit providers and we will share this strategy with the market.

[3] Insurance and Pensions Supervision Division (I&P), Lending, Saving and Retail Investment Supervision Division (LSR), Accountants and Reporting Supervision Division (AR), Market Integrity and Enforcement Supervision Division (MIE), Asset Management Supervision Division (AM), Capital Markets Supervision Division (CM)

I&P is committed to mitigating the **'Disappointing financial position after retirement'** risk. The following objectives are guiding:

+ Consumers have a comprehensive overview of their income and assets on and prior to the date of retirement.
+ Consumers facing a potential decrease in income after retirement become aware of this in time, and know what they have to do to cope with this decrease. Within this objective, we will focus on groups of people who are specifically vulnerable to developing a pension shortfall, such as self-employed persons and divorced couples.
+ Pension products are cost-efficient and are in line with the needs of the consumer/participant.
+ Consumers and employers make conscious and responsible choices about their pension and receive proper guidance from pension providers and advisers. More specifically, the focus will be on pension advice to employers and the degree to which pension providers and advisers provide guidance to participants in making the choice whether or not to continue to invest after their retirement date.

In addition, we bring the interest of pension scheme members into the key debate on the second pillar pensions. In this context, we also examine the impact of aspects of a potential new pension system on the behaviour of participants. For example, what works in terms of freedom of choice in a new pension system and what are the preconditions?

To reduce the **'Legacy problems of insurers'** risk, I&P is identifying vulnerable customers who have an investment-linked policy, and we will see to it that financial companies actually help these customers. In addition, I&P charts which elements within the product architecture of defined contribution and defined benefit pension schemes can lead to foreseeable disappointments among the participants and I&P will urge the sector to make adjustments in the interest of participants. In addition, the AFM is working on a future analysis with regards to the chain of insurers, proxy parties, advisers and intermediaries.
This centres around the question of the extent to which parties in this chain are able to respond to relevant developments, such as the high degree of digitalisation and the associated risks in view of a careful treatment of clients. Also, we are conducting a follow-up survey among a number of insurers regarding change capacity and succession planning in the financial sector.

To lower the **'Vulnerability of customer data'** risk, I&P, together with LSR, is assessing to what extent financial companies handle customer data carefully. The focus is on the prevention of 'product pushing', 'exclusion' and 'miss-selling', for example, by making use of data to create a customer profile to which they tailor their service provision (profiling).
The use of customer profiles may result in stigmatisation of customers. I&P is responsible for the further development and implementation of the Customer Interests Dashboard. Through the Customer Interests Dashboard, the AFM aims to encourage the sector to always place the customer's interests first in their products and services. In addition, I&P, together with LSR, will continue to monitor new trends in the area of product development. Within the context of supervision of product development processes, I&P and LSR will subject the various products to a further annual investigation. Finally, the AFM supervises advisers, intermediaries and proxy parties on an ongoing basis, emphasising compliance with the ban

on inducements, cooperation in the chain, innovation and professional competence. The Ministry of Finance will review the ban on inducements in 2017. To facilitate this review, the AFM provides the research bureau with market data, and also acts as a sounding board/expert during the research.

3.1.2 Division Lending, Saving and Retail Investment Supervision (LSR)

The Lending, Saving and Retail Investment Supervision Division (LSR) has three teams. Two teams each focus on a specific market segment: 'Lending and Saving' and 'Retail Investment'. The 'Supervisory Intervention' team supervises the provision of information, product development processes, problematic cases and the settlement of incidents. In addition to LSR, this team also facilitates the Insurance and Pensions Division (I&P).

To lower the **'Low interest rate environment'** risk, the AFM, through the use of behavioural science experiments, determines the most effective opportunities for mortgage loan holders (investment-linked mortgage loans and interest-only mortgage loans) to benefit from the low interest rate environment and decrease their vulnerability. LSR also sees to it that financial companies encourage vulnerable households, specifically vulnerable homeowners with interest-only and investment-linked mortgage loans, to reduce their debt and build up their assets. The aim is to achieve a significant reduction in 2017 of vulnerable borrowers with an interest-only or investment-linked mortgage loan. In addition, LSR is creating an overview of high-impact low interest rate environment products that are unsuited for the current low interest rate environment or that insufficiently account for possible interest rate rises. The aim is to prevent financial companies from offering products that do not meet the CUSC criteria and are therefore not suitable for consumers. Also, LSR seeks to ensure that financial companies provide comprehensible advice with products that could have a high impact on customers.

To lower the **'Risk of excessive lending'**, we are charting the scope and characteristics of the population of vulnerable consumers with consumer credit. We are also creating insight into the market landscape of consumer credit, including a complete overview of outstanding loans that are currently not or only partially being repaid. These insights are necessary to arrive at effective supervisory approach. In addition, we are investigating consumer decision-making behaviour in practice together with market parties. We will then translating these insights into supervision recommendations. LSR aims to improve the online decision-making environment for consumer credit so that the customer's interests are safeguarded better.

To mitigate the **'Search for yields'** risk, we are investigating the occurrence of this phenomenon and possible risks and consequences hereof. The AFM will publish its findings in a report that will include an analysis and the AFM's point of view. In addition, we are looking for an alternative suitability test that offers better protection to execution only-investors and we are charting the use of debt financing by investment firms. We are also identifying whether and how the market is moving towards new high-risk products/services and the risks associated with this.
The marketing conduct of investment firms also demands our attention.

To reduce the **'Arrival of new players'** risk, LSR is generating insights into the scope of and developments in the market for alternative credit providers. Based on these insights, we will determine a strategy to recognise and reduce risks in respect of alternative credit providers and we will share this strategy with the market. In addition, we seek to ensure that financial companies that are supervised by the AFM implement the AFM's view on the duty of care and realise controlled business operations in a digital environment.

In addition to the reduction of the top 10 risks, LSR mainly supervises lending (including debt-collection and overdrafts) investment services provision (including the service models of investment firms post the inducement ban) and the provision of financial services to corporate clients. LSR furthermore oversees aspects relating to the implementation of new laws and regulations.

An important topic is the provision of interest rate derivatives services to non-professional SME clients. The adoption of the uniform recovery *framework* for interest rate derivatives was an important breakthrough. The end of 2016 saw the start of the implementation of the uniform recovery framework. In this phase, the AFM, through partial observations, monitors the correct implementation of the recovery framework by banks and external assessors. Banks must review all cases for compliance with the uniform recovery framework, including cases in which compensation has already been offered or received by customers. The work of the banks will be checked by external assessors. The AFM starts its inspection process as soon as the banks have calculated their recovery proposals for customers or sub-groups of customers and these have been signed off by the external assessor and sent to the client. Banks must correct errors found by the AFM. The AFM will report to the Minister of Finance on the progress at least twice a year, in March and in September 2017.

3.1.3 Accountants and Reporting Supervision Division (AR)

The Accountants and Reporting Supervision Division (AR) seeks to ensure that audit firms and their reporting comply with the relevant regulations and expectations of society and the alignment thereof. To that end, supervision focuses on the audit activities to ensure that audits contribute to confidence in the reliability of financial reporting and thus also in the performance of the financial markets.

To reduce the **'Insufficient quality of auditors'** risk, in 2017, the AR division will apply most of its capacity to encourage, motivate and drive necessary changes in the profession, and the structural incorporation of these changes in audit firms. These changes include important aspects of internal control, internal supervision and changes in conduct and culture within the audit profession. To that end, the current 2017 supervision theme that requires audit firms to put the public's interests first in their audits, will be continued. The AR division will also put in a substantial ongoing effort to check the quality of audits. Following the completion of the second assessment of Big 4 audit firms, the quality of audits performed by other firms will be assessed.
Assuming that the Act on Additional Measures for Audit Firms will have been implemented by 1 July 2017, the AFM will start to assess the suitability of policymakers in 2017. This is one element of the 53 measures for the profession and fulfils a long-held wish of the AFM.

In addition to the above activities, the AR division will also focus on the ongoing supervision of financial reporting and will carry out thematic reviews of financial reporting in 2017. Through its thematic reviews and publication thereof, the AFM further demands attention for compliance with specific reporting requirements within a certain sector.

In 2017, we will also look at Big 4 audit firms' incentives to become or join as a new partner in order to reduce the **'Insufficient quality of auditors'** risk.

3.1.4 Supervisory Division Market Integrity and Enforcement (MIE)

The Market Integrity and Enforcement Division Supervision (MIE) looks at ways to combat serious violations of laws and regulations by illegal, exempt and licence-holding parties. This concerns violations that are harmful to consumers, SME companies and bona fide market parties, or violations that erode or could erode the trust in or the integrity of financial markets in another way. In addition, MIE focuses on the integrity of operations and of policymakers.

To lower the **'Risk of excessive lending'**, the AFM encourages responsible credit provision conduct of market parties. We combat mala fide parties on the market for consumer credit. The MIE division, together with the other relevant divisions within the AFM, will develop an integral supervision strategy for the consumer credit market to that end in 2017. The MIE division will contribute its expertise in the area of serious violations of laws and regulations, and is responsible for the mitigation of serious violations in the consumer credit market. We are charting the entire consumer credit market, developments and risks. Our insights will be compiled and will form the foundation of our substantiated approach in the years to come. This consumer credit supervision strategy will also provide insights into the way in which an online decision-making environment can minimise online marketing risks for consumers.

To better understand and lower the **'Search for yields'** risk, the MIE division seeks to curb the sale of investment products that are not in the interest of consumers and SME customers. Consequently, MIE will step up the actions taken against mala fide market parties who aim to benefit from the demand for investment products, whether or not by setting up tax avoidance constructions or non-transparent constructions with legal entities.
In addition to reducing the top risks, the MIE division carries out ongoing supervision whereby the AFM focuses on combating abuses ('black conduct') in financial markets by monitoring the integrity of financial companies that hold a licence, are exempt or operate illegally and by monitoring illegal financial activities.

3.1.5 Asset Management Supervisory Division (AM)

The Supervision Asset Management Division (AM) supervises asset managers in order to protect the interest of investors.

To lower the **'Search for yields'** risk, AM seeks to ensure that asset management parties always serve the interests of investors adequately. Specific attention is paid to parties that have received an AIFMD licence by operation of law. In 2017, the division will also perform a broader analysis of the systemic risks of asset management activities. One area they will focus on is the use of leverage.

To reduce the **'Arrival of new players'** risk, AM will ensure that new and existing crowdfunding parties hold the appropriate

AFM licence. In the 2016 Legislative Letter, we advocated general requirements in the Dutch Financial Supervision Act (FSA, Wft). In addition, AM supervises that asset managers, portfolio managers and custodians implement the AFM rules for controlled operations in a digital environment.

In addition to reducing the top risks, AM's duties include the preparation and implementation of new legislation, in particular MiFID II. The division participates in international working groups, including working groups that focus on financial stability. AM is one of the divisions that is already applying data-driven supervision knowledge. This will be extended in 2017.

3.1.6 Capital Markets Supervisory Division (CM)

The Capital Markets Supervision Division (CM) promotes that the supply and demand of capital and risks can come together in a fair and efficient manner.

To further investigate and reduce the **'Search for yields'** risk, CM performs scenario analyses of the consequences of price shocks on capital markets.

To reduce the **'Arrival of new players'** risk, CM incorporates insights from its research into consumer behaviour into the further development of a crowdfunding supervision strategy. CM also monitors that AFM's view on controlled business operations is implemented by trading platforms.
To reduce the 'Price formation capital market' risk, CM will pay more attention to controlled trading and take adequate measures to ensure a robust trading infrastructure. In addition, CM aims to ensure efficient and transparent price formation in the market. Institutional investors benefit from the best price for financial instruments and should have the opportunity to detect the best price. Smaller investors should be able to rely on being offered the best price by their broker. In the extension of its supervisory duties in the area of capital markets, CM uses data-driven risk analyses and sharply focuses on new market segments. CM aims to quantitatively supervise the trading conduct of companies and to respond quickly to high risk behaviour.

In addition to reducing the top risks, CM supervises the quality and reliability and the functioning of the trading chain; from order to settlement. This includes preparation and implementation of new legislation, in particular MiFID II. CM is one of the divisions that already applies data-driven supervision knowledge. This will be extended in 2017.

3.1.7 Innovation & Fintech Programme

The Innovation & Fintech Programme Team will ensure that the AFM keeps up with innovation in the financial sector to the extent that this contributes to sustainable financial well-being in the Netherlands. Another task is to identify and mitigate risks associated with innovations. In addition, we encourage innovations that serve the customer's interests. We constructively contribute to the drafting of new regulations for these new concepts and players. In addition, the programme team monitors innovations and developments in the financial sector on an ongoing basis. For monitoring purposes, contact is maintained with financial and technological market parties, boards of political and international forums and fintechs in the InnovationHub. Where necessary, we identity new risks and opportunities for the AFM and the market on the basis of these activities.

The InnovationHub of the AFM and DNB (The Dutch Central Bank) is available to market parties that wish to introduce innovative financial services or products on the market and that have questions regarding regulation. The InnovationHub provides new businesses and existing market parties with the opportunity to discuss issues directly with the supervisory authority, regardless of whether or not they are subject to supervision.

To reduce the **'Vulnerability of customer data'** risk, the Innovation & Fintech Programme aligns its activities with those of the Dutch Data Protection Authority.
To reduce the 'Arrival of new players' risk, the Innovation & Fintech Programme is developing a view on how the duty of care should be implemented in the provision of innovative financial services. Taking this view as a basis, the division focuses on the use of new instruments such as automated advice, cloud services and online enticements techniques, to name a few. Actions are substantiated by legal and behavioural economics insights.

In addition, the programme is also developing a view on controlled and ethical operations in the digital environment of both existing and new players. Cyber security risks form an important element hereof. Another element is the way in which companies handle governance of outsourced IT operations.

To reduce the **'Cyber Crime'** risks, we are identifying the degree to which trading platforms and new payment service providers are able to withstand cyber-related threats. Furthermore, we are further investigating the risks of unauthorised access to the online transaction environment of providers, such as securities investment systems and custodian banks.

3.1.8 Strategy, Policy and International Affairs Division (SPI)

The AFM, in the execution of its activities, operates in an international playing field. Financial markets are international by nature, and financial market parties often operate across borders. The AFM therefore also plays an important international role, for example, in the contribution to standards, the promotion of international cooperation and harmonisation of supervision. The international activities of the AFM have the following four objectives:

+ Exert an influence on policy relevant to the AFM and Dutch stakeholders in international policy and regulation processes.
+ Learn from other supervisory authorities and their approach to supervision.
+ Detect international developments in an early stage and, where necessary, incorporate these in the supervision by the AFM.
+ Cooperate with other supervisory authorities in cross-border supervision issues.

The developments described in 2.3 directly influence the AFM's mission and priorities and call for its international engagement. As the supervisory framework of the AFM is largely determined by EU regulations and international standards, it is important that the AFM is involved in the drafting and subsequent adoption hereof into Dutch legislation in an early stage. Expectations are that in the coming years initiatives of the European Commission will not be as far-reaching as the revision of MiFID and the introduction of EMIR, for example. Still, the legislative agenda in the area of financial markets will continue to demand the AFM's attention. Consequently, the AFM will apply its resources to advise the Ministry of Finance during negotiations within Europe, and the adoption into national law of previously adopted EU legislation.

The increasingly important role of the ESAs and other international organisations such as the IOSCO, demand the AFM's active involvement in these organisations. The AFM exerts influence on the strategic direction of relevant international boards by holding high-level influential positions, and through active participation in working groups that determine policies. To be in a position to influence policies, the AFM will continue to invest in its relationship with the most active members of these boards. In international discussions on capital market related financial stability issues, the AFM contributes to a constructive dialogue and cooperation with prudential supervisors.

Harmonisation of rules and convergence of supervision require the AFM to remain alert, also in view of typical national achievements and the AFM's risk-based supervision. This is particularly true when primary legislation is drafted in Brussels and when standards are set by organisations such as the ESAs and the IOSCO, for example. As supervisory convergence is a priority for the ESAs, the AFM intends to contribute substantially, specifically in this area.

Finally, in addition to having positive effects, the further internationalisation and integration of financial markets, also as a consequence of the harmonisation of regulations, entails risks, such as supervisory arbitrage. Ongoing investment in the cooperation with other international supervisory authorities is therefore imperative.

3.2. Priority 2: Strengthening and renewing supervision through focused investment in technology and methodologies

The AFM aims to be a demonstrably ground-breaking supervisory authority in 2022. That is why we invest in data-driven supervision and why we strengthen our research methods. We are building a technology and data-driven organisation so that we can respond to changes in society and technological changes in financial markets. We are investing in new systems that enable the analysis of huge quantities of market data.

We have also founded an Expertise Centre (EC) that collects insights into the conduct and culture of companies, as well as into consumer behaviour, which insights are then used to make our supervision more effective and efficient. Various disciplines come together within the Expertise Centre:

+ Data-driven supervision
+ Supervision Intelligence
+ Quality Assurance Supervision
+ Consumer and investor behaviour
+ Behaviour & Culture

The EC opens up areas of expertise and interventions to innovation and contributes alternative perspectives to arrive at better decisions on supervision theory and practice. That is how the EC supports supervisory divisions.
In addition to helping the supervisory divisions to reduce the top risks, the EC contributes to supervisory activities and the quality of supervision by providing ongoing risk analyses, Quality Assurance supervision and support for project-based work of divisions.

3.2.1 Data-driven supervision

Data-driven supervision makes supervision more effective and efficient. It helps us to chart the markets that we supervise, and it provides a substantiation. It allows the AFM to take better targeted action earlier, as it enables the AFM to detect trends and issues in the markets earlier. This is possible because we are making better use of available data, technology and methodology and we are developing the right skills and competences.
Data-driven supervision requires a good organisation of our data management and data-analysis processes, as well as the expansion of the data-analytical capacity of our organisation.
To achieve our ambitions, we started with the 'Spot-on' programme in 2016. In 2017, the programme will support the transition to a data-driven supervisory authority, and improve our supervision by facilitating data research and the development of a data and analysis platform. By developing the platform, we are building a safe, sustainable and future-proof environment that allows for the use of data in primary supervision in a modern, flexible and user-friendly manner.

3.2.2 Supervision Intelligence

The Supervision Intelligence team gathers, prepares and analyses market data. This is done in the context of supervisory investigations, which may or may not confirm a suspicion of an offence, and to gain insight into trends and risks in the various financial sub-markets. The team cooperates closely with the data-driven supervision programme and the supervisory departments.
Besides the ongoing activities within the framework of digital research and market data analysis, we will work on the further development of data-driven supervision and supervision of cyber crime in 2017.

In 2017, we will also continue our development of our Open Source Intelligence expertise, allowing a more effective analysis of open or semi-open sources. This type of analysis enables us to detect concealed connections between persons and companies during the initial phase of an investigation.
In 2017, Supervision Intelligence will continue to develop expertise in linking and analysing multiple data sources, generating new insights that are relevant to supervision.

3.2.3. Quality Assurance Supervision

The AFM is working on increasingly efficient and effective research methods. This will continue in 2017. We are examining the:

+ quality of problem analyses
+ research methods used
+ effectiveness of supervisory interventions
+ use of results to improve the efficiency and effectiveness of supervision.

3.2.4 Consumer behaviour and conduct of investors

Towards the end of 2013, one of the internal themes of the AFM was ‘Understanding and reinforcing the financial consumer’. It focused on better and more frequent application of scientific insights into the decision-making behaviour of consumers in our supervision. Since 2016, the theme found expression in the Consumer Behaviour team that is part of the Expertise Centre.

Using its knowledge of consumer behaviour, this team continues to work on improving the effectiveness and efficiency of the AFM and its instruments. Their aim is to positively influence the online decision-making environment of the consumer in a measurable manner. We are working on projects in which use is made of behavioural science insights. These are used to understand why consumers do what they do and, more specifically, to modify their decision-making environment in such a way that it will be easier for them to make decisions that better serve their interests. Where possible, we assess whether or not the solutions that we propose (based on those insights) actually work through empirical experiments.
We apply this method to support our supervisory divisions with the reduction of the top risks.

3.2.5 Conduct and culture of companies under supervision

The visible conduct and existing culture of a business are important indicators of potential future problems. In addition, cultural changes at companies are often a necessary prerequisite to improve operations and services.

The Conduct and Culture team is committed to creating an organisational culture at financial market parties in which fair and transparent service provision comes first. Based on this mission, the team contributes to the AFM’s mission, and, more specifically, to the reduction of the top risks listed under priority 1. The team takes two routes:

+ Direct investigations at market parties, both within the context of top risks and on the basis of signals and risks observed by the team itself.
+ Development of knowledge, expertise and methodologies (regarding conduct and culture) that improve the effectiveness of the AFM and its instruments.

3.3 Priority 3: Increasing the effectiveness, efficiency and agility of the AFM's organisation

To be able to quickly respond to the external challenges faced by the AFM, our internal organisation needs to change as well. In 2017, we will continue along the path taken in 2016; we aim to increase the effectiveness, efficiency and agility of our organisation and employees. In doing so, we will keep the following three priorities in mind: strengthening our management, making our operation more professional, and accountability. In 2016, some steps were taken already. These include the simplification of the organisation, the start of the leadership programme, the optimisation of a number of important processes, the improvement of the IT organisation and the AFM Working Method pilots.

In 2016, the AFM elaborated the plans in more detail and tested them in pilots. The plans will be implemented across the board in 2017. Initially, emphasis will be placed on implementation. Sustainable changes to day-to-day activities take time.

Due to a combination of causes, AFM's evaluations of the reassessments of interest rate derivatives by banks fell short of the mark. Alvarez & Marsal concluded this in their report .

Based on lessons learned from this report, the AFM is introducing improvements in the way of working within the AFM. A number of the measures were already implemented in 2016 or introduced as part of our strategy. Following the report, we will review the risk profile of projects every quarter in 2017. The progress in high-risk cases will be periodically discussed within the board. We are increasingly working towards a culture of debate, cooperation and mutual learning. The management will take the lead in this. These principles have also been laid down in the AFM Working Method.

3.3.1 Strengthening the management

In 2016, the AFM proceeded to further fine-tune and structure its management model. In addition to the reorganisation of the supervisory organisation and adopting a more uniform management approach, a management dashboard has been designed. In this context, duties and responsibilities have been redefined and explicitly allocated. The main focus in the year 2016 was the design of the management model, and the provision of guidance to the first teams working with this model. This new management model will be implemented across the whole AFM organisation in 2017.

AFM leadership

As part of strengthening and setting up the management model, we invested in the development of leadership within our organisation. Based on our view on leadership, a leadership programme has been designed. In first instance, especially higher and middle management will participate in this programme. In addition to personal, results-oriented coaching and inspirational leadership, substantive leadership will explicitly be put on the agenda in 2017. The leadership programme is a mix of InterVision and training of management skills aimed at working in line with the AFM Working Method on a daily basis. In 2017, a leadership programme for employees will be launched as well.

The AFM Working Method

The AFM Working Method offers a clear framework to ensure that we will work together more effectively as one professional organisation. This framework provides guidance on how we will cooperate with each other and our stakeholders on a daily basis. Our working method offers three perspectives that are linked to and reinforce each other:

1) short, cyclical management
2) ongoing process improvement
3) a culture aimed at achieving shared goals, open communication, giving and receiving feedback, cooperation and mutual learning.

Initially, divisions are supported intensively by a coach and a detailed four-month implementation plan that includes various sessions to become familiar with the working method. The divisions will subsequently start to apply the working method, and regularly discuss positive improvements offered by the working method.

In 2016, two pilots were held with a positive outcome. The working method will gradually be implemented by the other divisions in 2017.

Development of Key Performance Indicators (KPIs)

Within the context of improving internal and external accountability and increasing the effectiveness and agility of our organisation (internal management), external and internal KPIs are currently being developed. Based on these KPIs, a process will be set up to improve short, cyclical management and the measurement of effects. We will continue with the further development of this in 2017 and we will add or tighten relevant KPIs where necessary.
We will define KPIs for various areas including for our strategic priorities in which the topic or reference point will vary. These may include, for example, specific risk reduction (such as a reduction in the number of consumers dealing with problematic consumer credit), our position vis-à-vis our stakeholders (reputation score and their satisfaction with regard to our accountability), and increasing our own efficiency (for example, by measuring the percentage of licences and exemptions that are completed within the specified time periods).
In addition, KPIs for processes and resources, for example, costs and FTEs, will be developed.

The aim is make the annual development and/or review of the most important performance indicators an integral part of AFM's future management cycles.

3.3.2 Professionalising our business operations

AFM's business operations support and facilitate supervision and the long-term ambition of the Agenda for 2016-2018. Our business operations form the foundation on which our organisation is based and upon which we can build further. We regard discipline as a key concept. Especially when it comes to cost control.

Computerisation

We started professionalising our IT organisation in 2016. The Information Provision Master Plan (IV) details the IT service provision improvements that are necessary for supervision and supervision support.
It is centred around three pillars; improvement of the infrastructure, simplification of the application environment and the improvement of the IT processes. This will ensure better control of IT processes, better reliability and better cost control. The programme will deliver its phased results as

from the end of 2016 to 2018 and will make a lasting contribution to the agility of our organisation.

Process improvement

We started to pay more attention to the improvement of processes in 2016. Where possible we will simplify our operational processes, combine strengths and avoid duplication of activities. The ongoing improvement of processes within teams forms part of the AFM Working Method. As a result, all teams will pay attention to this. In addition, both 2016 and 2017 will see improvements to the three AFM pillars. At the end of this period, a number of employees will have taken Lean Six Sigma method training courses. We will continue with this in 2017 Furthermore, a project to take risk management to the next level throughout the organisation was started in 2016 and a cost-control programme was also set up. This will be implemented in 2017.

Employee development

Attracting and retaining talented employees is very important to the AFM, as is the ongoing development of our employees to bring out the best in them. The HR strategy will be realigned in 2017 to ensure that we continue to be able to attract and retain the right people in the years to come. Strategic employee planning is an important foundation in this respect. Attention will also be paid to training and education in 2017 through our training programme and the courses offered by the Supervision Academy. Finally, the pension fund will switch to another pension institution in 2017.

3.3.3 Reporting

The AFM is a learning supervisory authority that applies lessons learned in the area of supervision, science and its own performance. We make an effort to engage in a dialogue with the industry and other stakeholders to not only speak to them but to also listen to them. We will do so in several ways:

+ Round tables and consultations
+ Stakeholder arenas
+ Consumer panel
+ Capital Market Committee, Financial Reporting & Accountancy Committee and Fintech Committee (in formation).
+ Advisory Panel

The new Expertise Centre will take targeted action to improve the focus on effective supervision. In our Agenda and annual report, we clearly communicate and show the choices made by us and how these increase the effectiveness of our supervision. In addition, we will take the first steps to use KPIs for the purposes of our external accountability in 2018 and in doing so improve our accountability.

04 Financial framework

The AFM observes an undiminished need to mitigate existing risks in financial markets in 2017. The adoption of MiFID II, PRIIPS, the Defined Contribution Scheme Improvement Act *(Wet verbeterde premieregeling)* and the suitability test for auditors expand our supervisory activities.

4. Financial framework

The AFM observes an undiminished need to mitigate existing risks in financial markets in 2017. The adoption of MiFID II, PRIIPS, the Defined Contribution Scheme Improvement Act (Wet verbeterde premieregeling) and the suitability test for auditors expand our supervisory activities. To perform these tasks well, we will structurally reinforce staffing and the IT infrastructure. Also, just as in 2016, we will invest in the further development of the organisation to become more effective, efficient and agile.

In addition, we aim to structurally renew our supervision in 2017. The Innovation and Fintech Programme will be strengthened and we will invest in the development of knowledge and tooling for the purposes of data-driven supervision. We will also invest in digital research and supervision of ethical and controlled business operations, such as cyber security.
In 2017, the AFM will mainly invest in hiring more staff (26 FTE or 4%) and higher training and consultancy costs.

At the same time, the AFM is limited by the cost framework set by the Minister of Finance (see below) and, starting in 2017, must comply with efficiency targets set to increase to 7% by 2020.
Overall, costs will increase by 7% compared to 2016, but are expected to decrease in the following years.
This section deals with the consequences that our policy will have for our budget.
Below we will explain the costs framework, the key figures, the costs per cost category and the investment budget. We will conclude with a description of the funding of the AFM.

Cost framework

Funding of the AFM is arranged for in the Financial Supervision Funding *(Wet bekostiging financieel toezicht)* Act, 'Wbft'. Under this Act, the Minister of Finance and the Minister of Social Affairs and Employment must annually approve the supervisory budget of the AFM.

The Minister of Finance has set a cost framework for the period 2017-2020. It is reflected in the following table.

Table 4.1 Cost Framework (*EUR 1 million)

External cost framework	2016	2017	2018	2019	2020
Starting point = 2016 Budget	92.2	92.2	92.2	92.2	92.2
Target (-1.75% each year)	-	1,6-	3,2-	4,8-	6,5-
Flexible layer (including expansion of duties)	-	5,0	6,0	7,0	8,0
Known expansion of responsibilities	-	*4,0*	*4,0*	*4,0*	*4,0*
Budget for unforeseen duties	-	-	*2,0*	*3,0*	*4,0*
Available budget for 2016 including carry over to 2017	-	1,0	-	-	-
Intensification (including development of organisation)	-	1,8	1,3	0,8	0,3
Wage and price adjustments *	-	1,1	2,0	2,9	3,8
Multi-year framework including wage and price adjustments	**-**	**98,4**	**98,3**	**98,0**	**97,8**

** assuming a 1% annual indexation as from 2018*

The amount for the adjustment of wages and prices for the 2017 framework is known. The 2017 framework figure therefore amounts to €98.4 million.

The AFM will make use of the one-time opportunity to carry part of the expected underspending of the budget for 2016 over to 2017. These funds will be used for investments in the development of supervision and the organisation.

It became clear in 2016 that the ambition of the AFM to change poses quite a challenge. We recognize the need to continue to invest in 2017 in strengthening support structures (such as IT, the management cycle, risk management, leadership, and the development of knowledge). These form the important basis for the realisation of our innovation, effectiveness and efficiency ambitions in the future as well.

[6] Parliamentary Paper 33957 no. 24

4.1 Key figures

Table 4.2 Key figures (*EUR 1 million)

	Budget for 2016	2016 interim report	Budget for 2017	Variance in comparison to B2016	Prognosis 2018	Prognosis 2019	Realisation 2015
Total expenses	92,2	91,2	98,4	7%	98,3	98,0	86,6
Average number of FTEs (including external hires)	609	607	635	4%	632	627	607

The total expenses budgeted for 2017 are 7% higher than in the 2016 budget and equal the cost framework for 2017. The budgeted expenses and staffing levels will be higher in 2017, mainly as a consequence of new statutory duties and additional investments required for data-driven supervision.

Deployment of FTEs

The table below shows the deployment of the FTEs in supervision in 2017. 'Other divisions' relate to operational departments, staff departments and the board.

Table 4.3: Average number of FTEs (including. external hires)

	Budget for 2016	2016 interim report	Budget for 2017	Variance in comparison to B2016	Prognosis 2018	Prognosis 2019
Insurance and Pensions Supervision	40	38	40	0%	41	41
Insurance and Pensions Supervision	40	39	45	13%	44	44
Accountants and Reporting Supervision	50	49	55	11%	55	54
Market Integrity and Enforcement Supervision	43	42	43	-2%	44	44
Asset Management Supervision	25	28	37	45%	32	31
Capital Markets Supervision	60	61	68	14%	69	69
Innovation & Fintech Programme	5	5	5	-2%	4	4
Expertise Centre	48	45	54	14%	57	54
Account Supervision	20	20	20	-2%	20	20
Service Centre Supervision	30	33	34	14%	35	35
Sub-totaal	**361**	**360**	**401**	**11%**	**400**	**395**
Direct Supervision Support	108	108	101	-7%	104	104
Other divisions*	139	139	134	-4%	128	128
Totaal	**609**	**607**	**635**	**4%**	**632**	**627**

** Trainees are allocated to supervisory divisions. In the Agenda for 2016-2018, trainees were included in other divisions*

Various divisions show an increase in the number of FTEs in the budget for 2017. The main reasons include extra work caused by new statutory duties and the transition to a more technology and data-driven market conduct authority.
For the Capital Markets Supervision and Lending, Saving and Retail Investment Supervision divisions, the increase in the number of FTEs is mainly caused by an extension of responsibilities in the context of MiFID II. For the Audit and Reporting Supervision division, the number of FTEs also increases due to an extension of the responsibilities in the context of the 'Audit firm suitability test'. The increase of the number of FTEs in 2017 for the Asset Management Supervision Division is mainly incidental in nature, and also relates to the expected number of licence applications under MiFID II. In addition, extra capacity is structurally deployed to focus on Financial Stability.
The number of FTEs within the Expertise Centre, also increases due to the development into a more data-driven supervisory authority. This is mainly incidental in nature.

Expenses by cost category

The table below shows the breakdown of expenses by cost category.

Table 4.4: Expenses by cost category (*EUR 1 million)

	Budget for 2016	2016 interim report	Budget for 2017	Variance in comparison to B2016	Prognosis 2018	Prognosis 2019	Realisation 2015
Salary expenses	48,4	47,4	52,0	7%	52,7	53,5	45,2
Social insurance contributions	6,1	5,9	6,6	8%	6,7	6,9	5,6
Pension expenses	9,5	9,6	10,4	9%	10,5	10,5	8,3
External staff	1,6	3,4	1,4	-10%	0,7	0,8	3,3
Other employee expenses	3,8	3,5	4,3	14%	4,1	4,0	3,4
Employee expenses	69,3	69,8	74,7	8%	74,7	75,6	65,8
Accommodation expenses	5,1	5,1	5,1	-1%	4,2	4,2	5,1
Consultancy expenses	2,8	3,4	4,2	46%	3,0	2,5	4,8
Incidental expenses change of pension institution	0,5	0,5	0,5	-	-	-	0,2
IT expenses	5,1	5,5	5,9	14%	5,1	4,9	5,2
General expenses	6,7	5,1	6,0	-10%	9,0	8,2	3,6
Depreciation	2,6	1,9	2,2	-15%	2,3	2,6	1,9
Total expenses	**92,2**	**91,2**	**98,4**	**7%**	**98,3**	**98,0**	**86,6**

The most important developments in the expenses per category in 2017 in comparison to the budget for 2016 are explained below:

- Employee expenses are €5.4 million higher. This is caused by:
    - Higher salary expenses (€3.6 million), mainly caused by a higher number of FTEs for new responsibilities. In addition, the salary expenses will be higher due to collective and individual salary increases based on the existing remuneration policy.
    - Higher pension expenses (€0.9 million), mainly as a result of higher salary expenses. The pension contribution is set at 25% of the wage sum, effective from 2016.
    - An increase of other employee expenses resulting from a higher training budget (€0.5 million). A large part hereof will be used for the development of knowledge of data-driven supervision.
- Higher consultancy costs (€1.4 million), mainly relating to support in the completion of the interest rate derivatives case and investments in the context of more data-driven supervision.
- Higher IT expenses (€0.8 million) resulting from investments in tooling for data-driven supervision and the development of new systems following MiFID II.
- Lower general expenses (€0.7 million), mainly caused by the release of an incidental reserve in the 2016 budget and a downward adjustment of the allocation to the provision for doubtful debts.

In the prognosis for 2018 and 2019, the lower accommodation expenses follow from new conditions, including the extension of the office building lease.

Table 4.5: Investment budget (*EUR 1 million)

	Budget for 2016	2016 interim report	Budget for 2017	Variance in comparison to B2016	Prognosis 2018	Prognosis 2019	Realisation 2015
Renovations	0,2	0,2	0,1	-65%	0,2	0,2	0,7
Furniture, fixtures and equipment	0,4	0,4	1,4	270%	-	0,1	0,1
Computer equipment & standard software	2,6	1,1	2,0	-23%	1,8	1,8	0,6
Customised software	1,0	0,3	0,2	-80%	0,2	0,2	0,2
Totale investeringen	**4,2**	**1,9**	**3,7**	**-12%**	**2,2**	**2,3**	**1,5**

Investment budget

The total investment budget for the year 2017 (€3.7 million) is €0.5 million lower than in 2016 (€4.2 million). The decrease is mainly caused by lower IT investments in customised software. Standard applications are used more and more. The investments in the IT environment mainly relate to the infrastructure for strengthening our supervision.

It is expected that our investments to become a data-driven supervisory authority will not yet translate into high capitalised costs in 2017, and associated depreciation. 2017 shows an increase in investments in furniture, fixtures and equipment. This concerns regular replacement of, for example, office furniture and audio-visual equipment.

The standard depreciation period for renovations equals the remaining term of the lease. The depreciation period for furniture, fixtures and equipment is five years and three years for computer equipment and software.

4.2 From budget to levies

Since 2013, the Financial Supervision Funding Act *(Wet bekostiging financieel toezicht, or 'Wbft')* provides for funding of AFM's total costs. Under the Wbft, the costs of supervision on the BES Islands (Bonaire, St. Eustace and Saba) pursuant to the BES Islands Financial Markets Act *(Wet financiële markten BES,* or 'Wfm BES') and the Anti-Money Laundering and Anti-Terrorist Financing (BES Islands) Act *(Wet ter voorkoming van witwassen en financieren van terrorisme BES, or 'Wwft BES')* have to be reported separately.

As a result of this, a distinction is made between the expenses on the basis of the Wbft and the funding for supervision of the BES Islands.

Table 4.6 Total expenses (*EUR 1 million)

	Begroting 2016	Halfjaar-rapportage 2016	Begroting 2017	Afw. tov B2016	Doorkijk 2018	Doorkijk 2019	Realisatie 2015
Expenses Wbft	91,8	90,8	98,1	7%	97,9	97,7	86,3
Expenses BES	0,4	0,4	0,4	-11%	0,4	0,4	0,3
Total expenses	**92,2**	**91,2**	**98,4**	**7%**	**98,3**	**98,0**	**86,6**

The breakdown of the total expenses is as follows:

The Financial Supervision (Funding) Act *(Wet bekostiging financieel toezicht,* or 'Wbft')
The budgeted costs pursuant to the Wbft amount to €98.1 million for 2017. The funding of the budgeted costs is shown in the table below.

Table 4.7 Operating difference Wbft (*EUR 1 million)

	Budget for 2016	2016 interim report	Budget for 2017	Variance in comparison to B2016	Prognosis 2018	Prognosis 2019	Realisation 2015
To be settled with the market parties of preceding years	**n.b.**	**n.b.**	**n.b.**	**n.b.**	**n.b.**	**n.b.**	**4,6**
Expenses Wbft	91,8	90,8	98,1	7%	97,9	97,7	86,3
Market contribution for ongoing supervision	*84,4*	*79,8*	*90,1*	-	*89,9*	*89,7*	*76,4*
Market contribution for non-recurring services	*7,3*	*7,3*	*8,0*	-	*8,0*	*8,0*	*7,3*
Penalties and incremental penalties to be settled with market parties	-	*2,5*	-	-	-	-	*2,5*
Penalties and incremental penalties payable to the government	-	*1,2*	-	-	-	-	*1,0*
Income	91,8	90,8	98,1	7%	97,9	97,7	87,2
Operating difference	**0,0**	**0,0**	**0,0**	**-**	**0,0**	**0,0**	**0,9**
To be settled next year	**0,0**	**4,5**	**0,0**	**-**	**0,0**	**0,0**	**5,5**
Amount to be settled with the market in the next year	0,0	3,3	0,0	-	0,0	0,0	4,5
Amount to be paid to the government	0,0	1,2	0,0	-	0,0	0,0	1,0

As from 2015, a government contribution is no longer required and the AFM's expenses under the Wbft are fully paid by the market. The AFM charges these costs to the market in two ways: a fee per service and/or an annual levy for the costs of ongoing supervision.

Market contribution for ongoing supervision

The expenses covered by an annual levy charged to market parties have risen from €84.4 million in the 2016 budget to €90.1 million in 2017. This is exclusive of amounts carried forward from previous years. The increase in the amount levied for ongoing supervision is due to the higher expenses as detailed in the beginning of this section and is mainly the consequence of new responsibilities, including MiFID II. For €0.7 million of the budget, the increase will be funded by a higher contribution from the fees for services, and the remainder will be paid out of the contributions for ongoing supervision.

The amount to be levied is allocated across 16 categories of businesses subject to supervision according to fixed percentages. These percentages are in principle fixed for five years and are stated in Annex 2 of the Wbft. The annual adjustments to the fees concern only changes to the measurement values and/or populations, changes in the overall costs of supervision and the amount of the operating difference. The amounts to be levied (excluding amounts to be offset from previous years) per business category on the basis of these percentages are included in the table below and form the basis for the fees for ongoing supervision in 2017.

[7] The percentages are subject to change as a result of changes to supervisory legislation and/or the composition of a supervisory category if the change in composition entails a substantial change to the supervision of that category.

Table 4.8: Market contribution for ongoing supervision excluding amounts carried forward from previous years (*EUR 1 million)

	% 2016-2017	To be levied in 2016	To be levied in 2017	Difference compared to B2016
Credit providers	2,2%	1,9	2,0	7%
Audit firms	10,3%	8,7	9,3	7%
Advisers and intermediaries	21,2%	17,9	19,1	7%
Settlement firms, payment institutions and electronic money institutions	0,1%	0,1	0,1	7%
Banks and clearing institutions	18,4%	15,5	16,6	7%
Managers of collective investment schemes and UCITS, as well as providers of investments and investment firms not engaged in proprietary trading (excluding operators of an MTF)	14,7%	12,4	13,2	7%
Investment firms engaged in proprietary trading	0,4%	0,3	0,4	7%
Central securities depositories	0,2%	0,2	0,2	7%
Central counterparties	0,2%	0,2	0,2	7%
Securities-issuing institutions: market	7,9%	6,7	7,1	7%
Securities-issuing institutions: reporting	7,2%	6,1	6,5	7%
Financial infrastructure: market operators and operators of an MTF	2,3%	1,9	2,1	7%
Pension funds and defined contribution pension institutions	3,5%	3,0	3,2	7%
Insurers: life and pensions	8,5%	7,2	7,7	7%
Insurers: non-life	2,8%	2,4	2,5	7%
Insurers: healthcare	0,1%	0,1	0,1	7%
Totaal	**100,0%**	**84,4**	**90,1**	**7%**

Market contribution for non-recurring services

The charges for non-recurring services, such as licence applications and the assessment of directors, are fixed for five years and are stated in Annex 1 Wbft, thus making these charges predictable over the longer term. The estimated income has increased from €7.3 million in the budget for 2016 to €8 million in the budget for 2017.

Penalties and incremental penalties

Income from penalties and incremental penalties is not estimated. However, this is passed on to the overall market through the operational difference up to a maximum of €2.5 million. The excess is paid to the government.

Operating difference

Operating differences occur every year as a result of differences between budgeted and actual expenses and income. Operating differences are settled with the market on the basis of the stated, fixed percentages.

Supervision of the BES Islands

The funding of the supervision of the BES Islands is arranged in the BES Islands Financial Markets Act (Wet financiële markten BES, or 'Wfm BES') and the Anti-Money Laundering and Anti-Terrorist Financing (BES Islands) Act (Wet ter voorkoming van witwassen en financieren van terrorisme BES, or 'Wwft BES'). The fees for non-recurring supervisory duties and ongoing supervision are stated in the underlying Regulation for the BES Islands Financial Markets (Regeling financiële markten BES). The government reimburses costs in excess of the market contribution as fees have not been set at a cost-covering level.

Table 4.9 Operating difference Wbft (*EUR 1 million)

Total expenses	Budget for 2016	2016 interim report	Budget for 2017	Variance in comparison to B2016	Prognosis 2018	Prognosis 2019	Realisation 2015
Expenses	0,406	0,4	0,363	-11%	0,4	0,4	0,3
Market contribution for ongoing supervision	*0,0*	*0,0*	*0,0*	-	*0,0*	*0,0*	*0,0*
Market contribution for non-recurring services	*0,0*	*0,0*	*0,0*	-	*0,0*	*0,0*	*0,0*
Government contribution	*0,4*	*0,4*	*0,4*	-	*0,4*	*0,3*	*0,3*
Income	0,4	0,4	0,4	-11%	0,4	0,4	0,4
Operating difference	**0,0**	**0,0**	**0,0**	**-**	**0,0**	**0,0**	**0,0**

The table above shows a very low market contribution, which rounded to the nearest million, is actually nil.

05 Appendix

Overview of organisational risks

Appendix 1

Overview of organisational risks

Major organisational risks	Control measures for 2017	Priority
There is an expectation gap in respect of the role and effectiveness of supervision, causing a lack of public support for supervision by the AFM (licence to operate/mandate).	**1. Stakeholders** a. Provide insight into the policy and the effects thereof to the government and society (accountability) b. Explain: Regularly explain the role and mandate and manage expectations on the basis of clear positioning and profiling, focusing on specific themes/ top 10 risks). Creating realistic expectations of politicians and society i.e. by communicating what the AFM does and does not do. c. Connect: Dialogue with stakeholders: targeted stakeholder management on the basis of the results of stakeholder surveys and linked to the positioning / profiling and top 10 risks **2. Issue management:** Limit damage to reputation and benefit from opportunities	**Priority 3 –** Optimising accountability
Political interest may conflict with the protection of public interests and may cause an imbalance between the role of the AFM and that of the relevant ministries.	Cooperate and preserve roles. Dialogue with relevant departments at all levels.	**Priority 3 –** Optimising accountability

Major organisational risks	Control measures for 2017	Priority
The quality and functionality of IT systems offer insufficient supervision support and insufficiently contribute to the desired security level and employees are insufficiently aware of the risks.	Investment in supervision systems (also for MiFID II) Professionalising operations – execute IT master plan	Priority 2 – Data-driven supervision Priority 3 – Professionalising operations
Insufficient knowledge retention, recruitment and advancement of staff in an expanding market and in a transition to a more data-driven supervisor.	Strengthen strategic personnel planning. Invest in recruitment and training to increase expertise.	Priority 3 – Professionalising operations
Insufficient focus on effects and agility of internal organisation.	Strengthen management, leadership programme	Priority 3 – Strengthening of management
Lack of knowledge, experience and capacity of AFM in view of our comprehensive statutory duties.	Cooperation with external parties such as universities and other domestic or foreign supervisors. Sharing knowledge and expertise	Among others Priority 2 – Establishment Expertise Centre
As we must set clear priorities within our wide range of tasks, there is a risk that we cannot pay sufficient attention to risks in the market in the performance of our supervisory duties.	Monitoring developments in the market as part of ongoing supervision. The occurrence of risks may require re-prioritisation.	Priority 1 – Reduction of undesirable risks in financial markets