Supervision in times of change

Agenda 2016 – 2018

January 2016

The Netherlands 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.

Contents

Foreword

Fair and transparent financial markets and sustainable financial prosperity in the Netherlands: this is the essence of our redefined mission in 2015 that is based on our statutory and social mandate. Our mission is the guiding principle for the future in everything we do. We can only be effective if we can also adapt to the changing requirements of the market and of society. Indeed, we supervise traditional companies as well as new players, new techniques and new risks.

It is not so much that we are living in an era of change; it is more that we are living in a change of era – an era that through shifting paradigms entails a different way of looking at things and a different approach. Whether you are a consumer, an investor or a financial enterprise, you will have noticed it: the possibilities that technology offers us, the increasing use of big data, and the arrival of new phenomena such as crowd-funding.

At the same time, your demand as an individual reader of this Agenda 2016-2018, and also the demand of the totality of all individuals, the society, is changing. Society continues to have high expectations of the financial sector, but also of the supervisory authority. This calls for accountability and transparency regarding the actions of all parties. At the same time, risks and responsibilities are being shifted onto individuals. It is a time in which more than ever, consumers have to take responsibility for their financial planning, while we see that this is difficult for a large group of consumers, and that a smaller group is completely unable to cope with this. Furthermore, this is a time in which we need to take a critical view of our own role as the supervisory authority. We are only too aware of this.

Last year, we formulated a long term vision under the aegis of a Multi-year Agenda (MYA) that aimed to strengthen our supervision and prepare us for the future. One important element in this new vision is our new core values. We are convinced that a supervisor has to find a balance between the values of 'vigour' and 'carefulness', and between 'autonomy' and 'connectedness'.

We believe that it is essential in these changing times to make connections with our consultation partners while preserving our autonomous position as the supervisory authority.

Our colleagues devoted much effort last year to making our long term vision and policy a reality. This Agenda for 2016-2018 is one of the results of this effort. We thank them for their engagement and dedication. We are confident that we, as Executive Board, together with all our colleagues, are working towards an inspirational new year of supervision of the financial sector.

On behalf of the Executive Board

Merel van Vroonhoven,
Chair

Management summary

We are living in an era of change and a change of era. Every day brings new challenges and developments that make our society look different from the way it was yesterday. As an independent conduct supervisor, we are a strong proponent of fair and transparent financial markets and we contribute to sustainable financial prosperity in the Netherlands. This is a challenging and also inspirational mandate that we are proud to take on.

All our activities – whether we are supervising banks and insurers, the local financial adviser or audit firms - are carried out as part of achieving this mission. And this objective determines the direction of our supervision. External developments then affect the areas to which we devote particular attention, and determine where our priorities lie and where we make specific investments.

Vision of changing supervision

As a supervisor, we continue to develop. Our ambition is to be a demonstrably ground-breaking supervisor by 2022, an AFM that is a leading supervisor and authority.

To be a demonstrably ground-breaking supervisor by 2022

We want to break new grounds as a supervisory authority because we want to have a continuing impact on our environment and do things that are relevant. This means that we anticipate and respond quickly to the changing world, and at the same time contribute to forming and influencing that world. This combination will ensure that we continue to be a leading supervisory authority and operate effectively.

This combination also means that we are aware of technological developments, that we understand them and use them for our supervision, and that we make the best possible use of the available data. We ensure that our supervisory interventions continue to be effective by using insights into behaviour and organisational culture. We understand the new developments, we are adaptable, and we adopt progressive ideas. We do this in concert with our stakeholders so that they know what they can expect of us.

We also look at ourselves, at our own effectiveness and efficiency. We want to show the effects we achieve in the sector and give account of this. It is important that our stakeholders are aware of our role and contribution. We measure the progress we make in increasing our effectiveness and efficiency.

Our ambition to break new grounds as a supervisory authority will be further developed next year.

Our core values are the intrinsic drivers in everything we think and do. They are our moral compass and the anchor of our supervision, which our supervisors refer to every day when making serious decisions. We are also approachable and accountable on this basis. Everyone working at the AFM on the basis of these values continually walks the line between 'carefulness' and 'vigorousness'. And they do this in 'connection' with the outside world and our stakeholders, without losing sight of our own autonomy. This is not always an easy task, but it is necessary and important.

Trends and risks

The financial markets are changing rapidly as a result of social and technological developments. This presents both opportunities and challenges, certainly in times when resources are not without limit. In order to decide where to focus our supervision, we have identified the major social and financial trends, and have *established our top 10 risks for the next three years.* *See chart on page 16.*

To address these top 10 risks effectively, we will make investments in the coming years and will focus on a number of priorities.

Priorities for 2016

The AFM has set itself the following three priorities for 2016:

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 adaptability of the AFM's organisation.

Priority 1: Reducing undesirable risks

In order to ensure fair and transparent financial markets and sustainable financial prosperity, it is important to contribute to the reduction of undesirable financial risks for society. In practice, this means that we focus on risks arising from the conduct of both traditional parties and new players.

We have revised our domains (or divisions) and the associated 'themes' (specific focus areas) in our supervision on the basis of this new context. We want focus, and have chosen to set ourselves an ambitious target over a term of three to five years. Besides the chosen themes, the regular supervision in the various domains will continue.

The diagram beneath shows the supervisory activities and themes that we will carry out in 2016.

Moreover, a new Asset Management division will be set up in 2016 to more effectively address risks associated with asset management. We will also initiate an Innovation & Fintech programme with the aim of understanding and promoting innovation.

Priority 2: Strengthening supervision

The social and technological developments in the financial markets also require a strengthening of supervision itself. To be able to mitigate undesirable risks for society, we need to invest in an organisation that is technology and data driven. We can only be an effective supervisor if we understand the techniques enterprises are using and how they are applying them. Furthermore, for the AFM it is essential to be able to gather, interpret and share information as efficiently and comprehensively as possible. The AFM accordingly needs to invest in new market monitoring systems that enable large quantities of market data to be analysed.

In order to identify risks in a timely manner, the AFM's social mandate and its contacts with its stakeholders are essential. For this purpose greater continuity and focus will be applied in the contacts with market parties, as well as, stronger direction from the management in these efforts, through the formation of an Account Supervision division. In addition, continuing attention will be paid to offering the outside world insight into our activities.

Promoting fair and transparent financial markets requires insight into the behaviour of people

Our methodology is another important item of attention for 2016. Promoting fair and transparent financial markets requires insight into the behaviour of people that either work in the financial markets or are purchasers of financial products and services. Our understanding of the behaviour of consumers and investors is growing, and shapes our understanding of where the greatest risks lie and how we can address them. The AFM also has to continue to increase its understanding of the behaviour and culture of financial institutions and subsectors in order to be able to prevent problems and to be able to carry out more effective supervisory intervention. This priority is mainly expressed by the formation of the Expertise Centre, which will work on accumulating knowledge regarding behaviour and culture, and new intervention techniques.

Priority 3: Increasing effectiveness, efficiency and adaptability

Finally, the AFM needs to strengthen its internal organisation in order to carry out its ambitious supervisory agenda. We want to simplify our organisation, work more efficiently, and improve our processes and risk management. Strong leadership and awareness of costs will be important in this respect.

Among other things, this requires strong direction. We will strengthen our direction by further developing our leadership and ability to change. We will invest in employees who will be result-driven and at the same time capable of self-reflection and empathy, with a sense of responsibility.

In addition, we will work on designing efficient and secure information systems and simplifying our working procedures where possible. Our decisions will be well considered, but they will also be vigorous. We will also invest in structuring our risk management. This will enable us to address new risks more effectively while at the same reducing our overheads.

Budget 2016

In order to introduce the necessary changes quickly, the AFM will make additional investments in effectiveness and efficiency between 2015 and 2017, the benefits of which will be felt in subsequent years. In 2015, the AFM intensified aspects of its supervision and introduced some initial changes. In 2016 it will make serious cuts in certain areas in order to make additional investments in new areas and to arrive at an appropriate budget. These strict decisions have made EUR 6.7 million available for the realisation of our ambitions. The dilemma here is to invest in renewal while at the same time devoting sufficient attention to mitigating existing risks and addressing new tasks. The total expenses budgeted for 2016 are 6% higher than in the 2015 budget, and amount to EUR 92.2 million. The increased expenses are mainly due to higher costs of information processing, higher employee expenses and higher general expenses. The budgeted average workforce will remain more or less unchanged in 2016.

Introduction

The AFM has a Multi-Year Agenda with the aim of becoming a demonstrably ground-breaking supervisory authority by 2022. The Agenda for 2016-2018 shows the steps we wish to take towards this long term ambition in the next three years, and clearly explains what we will do in 2016.

The AFM has set itself the following priorities for 2016:

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 adaptability of the AFM's organisation.

The Agenda presented for 2016-2018 shows how these priorities will be pursued in 2016 and offers a budget for 2016. Firstly, the document presents an overview of the major external trends and risks for our supervision. Naturally, these external developments also affect the design of our own organisation. We welcome you to view our vision of changing supervision, the way in which we selected our priorities, and the new design and direction of the AFM. We conclude by presenting our budget in the financial section.

1. External developments

The financial markets are changing rapidly as a result of social and technological developments. The effect of international developments and the interconnectedness between international and national players are accelerating this process.

This section outlines the major trends and risks in the financial markets and in society at large. These trends and risks are fundamental. They are developing slowly, and change over time. There were no significant changes to external risks identified last year. The AFM concentrates on the most important trends and risks.

These movements obviously also affect the design and focus of our supervision. The following sections address this in more detail.

The four major social trends

The AFM identifies the following social trends 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 regulation such as EMIR and MiFIR mean that supervisors have an ever-increasing amount of data available. This requires heavy investment 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 regulation already originates 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 supervisor is expected to prevent abuses. In many cases, people expect a supervisor 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 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 give account of the effectiveness of our actions, partly due to this development.

The five most important financial trends

The AFM has identified the following major trends in the financial markets:

1. The low interest rate environment has had a major impact on the financial markets and has an accelerating or strengthening 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 on 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, meaning that personal financial planning is becoming more important.
Risks are increasingly shifting 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.
Traditional financial enterprises have, in the past years, made progress on making the customer's interests a priority in their organisations, but we see that they are having difficulty in permanently embedding the change to behaviour and culture that is needed. This continues to lead to minor and major incidents.

4. Technological developments are leading to the arrival of new players and are putting the earnings models of traditional players under pressure.
Technology creates opportunities for new players and makes new earnings 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 driver of profitability for many parties.

5. The shift away from finance provided by banks to market finance 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 finance to market finance will also mean that the risks become more international in nature.

The ten most important risks

The trends described above could lead to specific risks for the various actors, such as consumers, investors or traditional firms. The top 10 risks have been formulated by clustering the risks that the AFM continuously identifies in the market. This top 10 does not include all the supervisory risks identified. The risks are prioritised on the basis of estimated impact and probability.

The schematic overview links the trends to the ten major risks, divided by actor. The risks cannot be directly linked to a single trend in all cases; they are frequently the result of a combination of trends. These risks are explicitly stated in the description of our priorities.

Figure 1.1: schematic overview of trends, actors and risks

Consumers and investors

1. Potential for excess borrowing by consumers in a low interest rate environment.
Due to the low *interest rate environment,* consumers can take on more or larger debt than is sensible in the long term. There is a risk that when interest rates rise, consumers will not be able to meet their monthly expenses, or that they are just about able to bear the monthly interest costs but will not have enough capital to repay the principal. Good *financial planning* is therefore even more important for consumers.

2. Investors (both consumers and asset managers) are not properly considering risks and returns in a low interest rate environment.
Due to the *low interest rate environment,* the return on traditional investments with relatively low risk is low. Investors are therefore looking for products that offer a higher return but which also carry higher risk. Any increase in interest rates or illiquidity could cause problems for investors.

3. Consumers are not active enough with respect to their financial life planning.
Consumers are increasingly having to take responsibility for their own *financial retirement planning*. Some consumers are not able to do this, or are not sufficiently aware of the issue. This calls for increased awareness and more propensity to take action. Otherwise, there is a risk of disappointment when the time comes to retire. Tax remains an important factor that influences the decisions made by many people in this area.

Traditional financial enterprises

4. Insurers are still dealing with problems from the past, and there are still financial incentives that potentially go against the customer's interest.
Insurers are still working on solutions to the past problems, for example the 'policies with excessive charges' affair (the *woekerpolisdossier*). Besides this, their business model is under pressure as a result of technological developments and low interest rates. In combination with the risk that insurers do not possess sufficient *ability to change* in order to give their customers central priority on a permanent basis, this could lead to new conduct risks.

5. The service provided by banks could deteriorate because their earnings model is fragmented and under pressure.

The banks used to provide a wide range of products and services. These products are now being offered more frequently by other parties, in some cases by newcomers. Some of the services *are shifting from bank finance to market finance*. This is partly due to the *low interest rate environment*. In addition, new parties are taking over some of these activities (such as crowdfunding). There is a risk that the banks will not be able to offer service at the same level to consumers and investors if they no longer carry a full range of products or services. This risk will increase if the banks have not developed sufficient *ability to change*.

6. Working practices by auditors still entail risks.

Incidents and structural findings are still coming to light that potentially result from undesirable behaviour or cultural elements that could indicate a lack of *ability to change*. In addition, the level of competitiveness in the sector as regards quality is relatively low. Audit firms do not appear to be improving the quality of their statutory audits to a sufficient degree, and do not appear to be able to ensure that improvements are permanent.

7. Asset managers are taking on an increasingly important role in the market. This calls for attention to governance and financial stability.

Partly due to the *low interest rate environment*, the role of liquidity provider is increasingly being shifted away from the banks and being taken over by asset managers. This *shift from bank finance to market finance* is also to some extent politically driven: legislation, in particular European efforts to create a Capital Markets Union, is designed to accommodate and strengthen this trend. The resulting concentration of capital at asset managers could lead to new conduct and systemic risks.

Traditional and new financial enterprises

8. Customer and market data are becoming increasingly valuable, and also therefore more vulnerable.

Financial enterprises possess an ever-increasing amount of data and have more possibilities for using these data. This applies at both existing parties and newcomers. Newcomers often use data more intensively than existing companies. The value of customer and market data continues to rise. This increases the possibility of wrongful use.

9. The risk of cyber attacks is greater in a data-driven society.
The increasing importance and usage of data means that the likelihood of abuse such as cyber crime is also increasing. Data have a high economic value. Data security and cyber security are therefore becoming more important. There is a risk that the business operation of financial enterprises is not sufficiently controlled in this respect.

New financial enterprises

10. The arrival of new players in the financial markets in areas such as payment services provision and crowdfunding creates opportunities as well as new conduct and systemic risks.
Technological developments make it possible for new parties to operate in the financial markets. These *fintechs* have the potential to radically change the current structure of the market. There is a risk of improper behaviour at these new parties. The lack of regulation for these players could lead to a conflict between profitability and safeguarding the interests of customers. Newcomers should not be immediately confronted with unnecessarily onerous regulation. At the same time, the level playing field could be temporarily distorted by the disparity between newcomers and established parties. As a supervisory authority, we have a role in restoring the level playing field in terms of regulation and supervision in situations where this inequality is unjustified and disturbs the market, which could in the longer run lead to a shift of risks.

2. Vision of changing supervision

The developments described above have led to a review of the AFM's mission and to changes to our organisation. It is not a *new* mission, since we have retained the essence of the old mission of 'fair and transparent markets'. It has however been *renewed,* since there are three notable differences between our previous mission and the current mission.

The old mission statement was: The AFM promotes fairness and transparency within financial markets. We are the independent supervisory authority for the savings, lending, investment and insurance markets. We promote the fair and conscientious provision of financial services to consumers and private investors, as well as professional and semi-professional parties. We supervise the fair and efficient operation of the capital markets. Our aim is to strengthen consumers' and companies' confidence in the financial markets, both in the Netherlands and abroad. In performing this task, the AFM contributes to the stability of the financial system, the economy and the reputation and prosperity of the Netherlands.

This section explains our current mission and our ambition to be a demonstrably ground-breaking supervisory authority by 2022. We discuss the steps needed to achieve this objective, and explain our approach to supervision.

Mission

The AFM is a strong proponent of fairness and transparency in the financial markets. As the independent conduct supervisor, we contribute to sustainable financial prosperity in the Netherlands.

An Ambitious Objective

In 2022 we will be a demonstrably ground-breaking supervisory authority

Core values

Care & Vigorous
Autonomous & Connected

Core qualities

- Discipline
- Analytical Strength
- Progressiveness

2.1 Our mission

A complex and changing world calls for increased focus of supervision. We have reviewed our mission in 2015 in order to sharpen this focus. The AFM continues to be a strong proponent of fairness and transparency in the financial markets. Among other things, this means that our stakeholders – the government, institutions, consumers and investors – must as far as possible be able to trust that everyone obeys the rules and that the rules are the same everywhere.

One of these differences is that the statement 'strengthen confidence' is no longer included

In the section below, we explain a couple of important differences in relation to our previous mission. One of these differences is that the statement *'strengthen confidence'* is no longer included. We have removed this in order to make it clear that the sector itself has to strengthen the confidence of consumers and investors. Another point is that the expression 'striving to strengthen confidence' in our mission statement could appear to contrast with our interventions (fines, orders for incremental penalty payments etc. and in particular the publication of these measures) which, in any case in the short term, do not enhance confidence in the financial sector. Such interventions are, however, necessary in order to effectively influence the behaviour of parties in the financial markets. This does not mean that the effects of our actions on confidence is no longer important, it simply means that not all our interventions also contribute to bolstering confidence.

In the renewal process, we have also decided to shorten our mission statement and strengthen it by focusing on its essence. We will also no longer specifically state the various markets (savings, lending, investment and insurance) and the separate attention to the retail market and the capital market. On the same principle, we have also omitted the statement of our contribution to financial stability. Our supervision will still have to make this contribution, particularly due to the shift from bank finance to market finance, which is bringing financial stability even more clearly into our supervisory domain.

Our effort to make our mission statement shorter and more inspirational has also led to a shortening of the sentence that includes 'the economy and the reputation and prosperity of the Netherlands', to bring it back to its essence. At the same time, we are expressing our view that wellness or well-being is more important than 'prosperity', which generally is considered to be more limited in its meaning. We also consider the addition of 'sustainable' to our new mission statement to be just as important. Firstly, this word expresses the point that we are not aiming for short term improvements, but that we are striving to achieve permanent improvement. Secondly, we refer to the concept of sustainability in the manner that this word is used in the context of corporate social responsibility, and the challenges that business, including the financial sector, faces in providing a strategic response to the ever more pressing ecological, social and governance (ESG) issues of our times.

2.2 An ambitious objective

The AFM has to redesign itself with supervision that is appropriate to the changing situation. Our ambition is to be a demonstrably ground-breaking supervisory authority by 2022: an AFM that is a leading supervisor and authority.

We want to operate in a *ground-breaking* manner because we want to have a permanent effect on our environment and address the relevant issues. This means that we anticipate and respond quickly to the changing world, and at the same time contribute to forming and influencing that world. This combination will ensure that we continue to be a leading supervisory authority and operate effectively.

This combination means that we are aware of technological developments, that we understand them and use them for our supervision, and that we make the best possible use of the available data. We will ensure that our supervisory interventions continue to be effective by making use of insights into behaviour and organisational culture. We understand the new developments, we are adaptable and adopt progressive ideas. We do this in concert with our stakeholders so that they know what they can expect of us.

We are taking ground-breaking actions by regularly reviewing and evaluating our own effectiveness. We do this by expressing our core values, developing our leadership and our people, and investing in the adaptability and efficiency of our processes. Developments in the sector and in supervision, both in the Netherlands and abroad, are leading in this process.

Demonstrable means that we can show the results of our actions in the sector and give account of them. It is important that our stakeholders, as well, are aware of our role and contribution. We measure the progress we make in increasing our effectiveness and efficiency.

Our ambition to become a ground-breaking supervisory authority will be further developed next year.

2.3 Core values

Core values are the guiding principles in our daily work, and support us when making decisions. We have chosen core values that show the considerations we have to make in the exercise of our supervisory duty.

The AFM is a strong proponent of fairness and transparency in the financial markets.
As the independent conduct supervisor, we contribute to sustainable financial prosperity in the Netherlands.

"We are careful and vigorous. We are autonomous and connected."

We discuss all points of view, we are aware of risks and consequences, and we reflect on our own conduct. We take action when necessary and make clear choices.

We are independent, we stand for our mission and we understand our profession. We listen to our stakeholders, we are aware of developments in the sector and outside, and choose a cooperative approach where this is possible.

2.4 Core qualities

To achieve our mission, every staff member possesses a set of core qualities. These include discipline, analytical strength and progressiveness.

The core quality of *discipline* forms the basis for our actions. This means that we make clear agreements and fulfil them, give account of our activities, and are clear regarding our priorities. Discipline helps us to increase our *analytical strengths* and provides the basis for our ability to act *progressively*.

The core quality of *analytical strength* is expressed in all our daily activities. An important part of supervision concerns the analysis of actions, developments and behaviour. The increased possibilities of the use of data are only increasing the importance of analysis. Analysis of data allows us to identify problems at an earlier stage and thus prevent them more effectively.

The core quality of *progressiveness* is expressed in our mentality and working practices, in the way we deal with each other and the outside world, in the cooperations we enter into and in our readiness to experiment with new instruments and measures.

2.5 The approach to supervision: how can the AFM continue to be effective?

The AFM uses a *risk-driven approach* whereby we apply our limited resources as effectively as possible. We anticipate new risks as early as possible. This means that the AFM is continually analysing market developments and risks.

Our supervision consists of a *combination of regular and thematic supervision*. Regular supervision concerns our work in connection with activities that the AFM carries out continuously as part of its statutory duty. This includes tasks such as the supervision of financial reporting, prospectuses and dealing with incidents and signals. Thematic supervision concerns supervision in relation to specific supervisory issues.

We work together with other parties in our supervision, such as The Dutch Central Bank (DNB). The AFM is also part of an international supervisory structure. Our international activities are designed to support our national interests or to ensure that these are not obstructed. We do this on a bilateral basis as well as in a broader context. We follow the international regulatory agenda, *exert influence* where this is needed, and support initiatives designed to promote convergence of supervision.

As a risk-driven supervisor, we focus primarily on undesirable behaviour in the financial sector. We contribute to discussions on legislation in order to ensure that sufficient effective standards apply to deal with undesirable behaviour, and that the AFM has sufficient instruments at its disposal to achieve this objective. We state our wishes in this context in our annual legislation letter.

Lastly, we focus on *measurement of the effect* that we achieve with our supervision. We focus on measuring the effect on conduct that we supervise, and which is established in regulations and standards. The perception of this by consumers and investors is also important. We therefore also measure the effects on both compliance and social perception. Compliance effects can be measured by determining whether institutions are following the regulations or standards. Social perception can be measured, for instance, by establishing whether consumers and investors change their behaviour as a result of the interventions by the AFM.

2.6 Steps in 2016-2018

The top 10 risks described above determine the focus of our supervision. These risks are monitored continually, evaluated annually, and updated if necessary. The AFM has set itself the following priorities in 2016:

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 adaptability of the AFM's organisation.

3. Our priorities for 2016

This section deals with our three priorities for 2016. Firstly, we explain the supervisory agenda for the coming three years, which aims to reduce undesirable risks for society (priority 1). We describe the ongoing activities we will perform in each division and for the Innovation & Fintech programme, and explain which major risks within themes (specific focus areas) will receive attention. We then turn briefly to the strengthening of supervision (priority 2) and increasing its effectiveness (priority 3).

The organisation of supervision

The AFM has divided its supervision of markets into various areas, or divisions. A division consists of one or more themes. Each theme refers to a specific, serious and urgent supervisory issue.

The supervisory divisions are assisted by the Expertise Centre (see section 3.7), the Supervision Service Centre and the Account Supervision division (formerly known as Ongoing Supervision). The Innovation and Fintech programme will also start in 2016. These activities are shown in diagram form below,

Supervision support

Expertise Centre programme

- Consumer behaviour
- Behaviour and culture
- Risk analysis
- Data-driven supervision

Account Supervision

- Relationship management
- Coordination and planning

Supervision Service Centre

- Licenses
- Suitability checks
- Registrations
- Business desk

Direct supervision

Innovation and Fintech programme

Theme of Innovation

Capital Markets Division

Theme of chain responsibility

Auditing and Reporting Division

Theme of PIE audit firms

Market Integrity and Enforcement Division

Theme of irresponsible lending

Theme of homeowners

Capital Markets Division

Theme under development

Division Lending, Savings and Retail Investors & Division Insurance and Pensions

Theme of small investors

Theme of homeowners

Theme of SME customers

Theme of pension products

Figure 3.1: diagram overview of direct supervision and supervision support

Activities in direct supervision in 2016 – 2018

Within this organisational structure, in the coming years the AFM will engage in the areas of capital markets, services to retail, auditing and reporting, enforcement, asset management and innovation.

Regarding the reduction of undesirable risks, our risk-driven supervision will be aimed at the top 10 risks. We have revised our divisions and their associated supervisory themes in this new context. We have sharpened our focus with a defined target over a term of three to five years. Besides our selected themes, the divisions will carry out their normal supervision, including the continuing handling of signals and incidents, prospectus supervision, and licensing. The supervisory activities and themes that will start in 2016 are shown in the diagram below.

Figure 3.2: how are the top-10 risks reflected in supervision?

3.1. Priority 1: Reducing undesirable risks for society

3.1.1 Efficient Capital Markets Division (ECM)

The aim of this division: *The AFM promotes the meeting of supply and demand for capital and risk in a fair and efficient manner.*

The capital markets have an important role in creating economic growth by bringing together supply and demand for capital and risk. Our supervision is designed to ensure that this happens as effectively as possible. The AFM is engaged in the improvement of the preconditions for capital markets finance.

Among other things, the ECM division is responsible *for the assessment of tender offers and prospectuses, supervision of trading platforms (both exchanges and alternative platforms), supervision of market manipulation, supervision of trading with inside information and conduct in relation to price-sensitive information*. In addition, the ECM division has identified a risk that is serious enough to warrant a thematic approach. This concerns the risk that internal controls at parties in the trading chain are inadequate, and the risks that exist because parties in the trading chain do not take sufficient account of the safeguards that they could provide regarding the proper operation of the chain or parts of the chain.

Background	Theme	Scope
The adequacy of internal controls at companies is under pressure due to: • Increasing regulatory pressure • Complexity of trading • Speed of trading • Fragmentation of trading locations	Chain responsibility in the changing market situation	Companies in the trading chain from order to settlement

Theme: "chain responsibility in the changing market situation"

Objective

In 2018 the players in the chain, from order to settlement (trading platforms, brokers, clearing and settlement institutions), will fulfil their responsibility for fair and controlled trading. This is what is meant by chain responsibility. This means that as far as possible the chain:
1) is free of interruptions
2) facilitates fair price formation, and
3) provides fair access to all appropriate users.
Fair in this case means that price-relevant information is not shared selectively but is accessible for all market participants.

An important part of achieving this objective will involve calling on the parties concerned to take individual responsibility. A maturity model will be used to measure the effects (on the basis of previously set levels) that will provide insight into the status of the internal controls at individual institutions. Statistics will also be used to monitor the operation of the trading chain. The theme will not in principle involve macro problems such as general liquidity or accessibility issues.

Activities in 2016

- Supporting parties in bringing the control of their business up to standard.
- Supporting parties in preparing for MiFID II, MiFIR and MAR.

Effect within 3 to 5 years:

- The chain for each financial instrument should continuously operate at a high level of quality and reliability;
- The parties in the chain should as far as possible be intrinsically motivated to achieve the desired effect and proactively seek ways in which they can contribute to the quality of the trading chain.
- A maturity model will be developed to measure progress.

3.1.2 Lending, Saving and Retail Investment Division & Insurance and Pensions Division

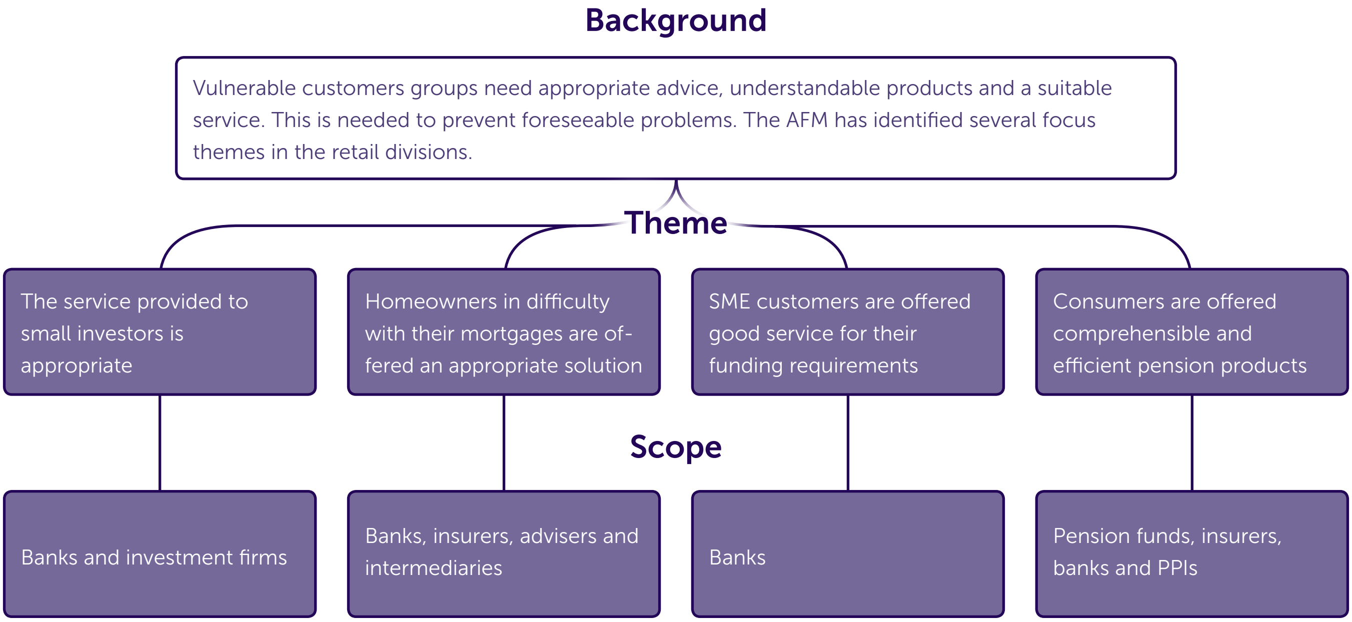
The AFM is responsible for supervision of the conduct of financial enterprises. Financial enterprises have a responsibility to give the interests of their customers central priority.

The supervision of services provided to retail customers was previously assigned to one division. This year, we have decided to split this division into two in order to keep the span of control manageable and to introduce sharper focus. The two divisions both have the same objective:

The AFM strongly urges financial enterprises to give the interests of their customers central priority

Among other things, the divisions are responsible for ongoing *supervision of information* and *the supervision of products and the product development process*.
The *Structure programme* intervenes to address the underlying causes of market failures in the retail market. In addition, the divisions monitor the retail market systematically by means of a *systematic monitoring function,* the *Customer Interests Dashboard* and an ongoing series of *exploratory reviews*.

The two divisions have identified four risks that are serious enough to warrant a thematic approach. These are described on the following pages.



Themes for the Lending, Saving and Retail Investment Division & the Insurance and Pensions Division

*There will be a review of whether our priorities in this theme need to be adjusted or added to on the basis of developments with respect to the interest rate derivatives issue.

Theme 'the service provided to small investors is appropriate'

Objective

The AFM strongly supports the suitable provision of investment services to investors whose primary aim is capital accumulation. The theme concerns the services provided by investment firms as well as execution only services.

To achieve this principal objective, the AFM encourages financial enterprises to offer appropriate product solutions to the various customer groups. In addition, providers need to be encouraged to offer support to both execution-only customers and customers taking an advisory service with the primary aim of capital accumulation in order to monitor the progress of their capital. Lastly, the AFM encourages providers to make more use of the insights of behavioural science in the design of their service provision. At the same time, we will take action against parties exploiting traps for investing customers.

Activities in 2016

- Influencing service providers to ensure that execution-only customers whose primary aim is accumulation receive an appropriate service;
- Encouraging institutions to offer support in monitoring the progress of the capital in relation to the primary capital accumulation target;
- Encouraging providers to make use of the insights of behavioural science.

Effect within 3 to 5 years:

- Execution-only investors will invest with a greater sense of purpose;
- More concepts using the insights of behavioural science in a positive manner will be deployed;
- Higher quality of investment advice/asset management will be realised, in which the customer's interests are given a central priority;
- Investment firms will have better insight regarding the progress of capital accumulation in relation to their customers' capital accumulation targets.

Theme 'Homeowners in difficulty with their mortgages are offered an appropriate solution'

Objective

The AFM strongly urges providers and advisers to give the interests of their customers central priority in their mortgage services.

The AFM will urge providers and advisers to *identify* risks at an earlier stage. When risks arise, they should *make the customer aware* of the situation and *proactively offer solutions* in order to mitigate the risks (for instance by rescheduling the mortgage). This problem affects a large number of people. Our own research indicates that 500,000 mortgages (as of Q2 2015) with an investment component will generate significantly less than the target capital. In addition, we note that there are 1.1 million mortgages that are fully interest-only and therefore constitute a potential risk (for instance, that there will be a residual debt).

The service provision needs to include greater attention to *customers during the term of the mortgage*. Monitoring of the portfolio and an active approach to customers at risk are important elements of this service.

Activities in 2016

- Urging providers and advisers to assist their customers in the identification of payment risks and the accumulation of capital to repay their mortgages;
- Identifying obstacles to switching;
- Checking whether customers are being approached proactively;
- Ensuring that providers and advisers also provide good after-sales services during the mortgage term.

Effect within 3 to 5 years:

- Homeowners do not get into (foreseeable) difficulties regarding their mortgage repayments;
- Consumers that are not accumulating sufficient capital for their mortgages are made aware of the risk they are exposed to;
- Providers, advisers and intermediaries make their customers aware of the risks they are exposed to.

Theme 'SME customers are offered good service for their funding requirements'

Objective

The interests of small business customers are given central priority.

As a result of the findings of the AFM business dashboard module in 2015 and the problems associated with derivative instruments, the AFM will further establish the major risks associated with services provided to businesses. This will enable us to identify the most vulnerable customer groups. The AFM wishes to see that banks give central priority to the interests of their small business customers in their products and services. Furthermore, it encourages the offering of clear information that supports good decision-making and the appropriate distribution of lending products. Regarding after-sales service, the AFM wishes to see that interest rates and spreads are justifiable and that these are communicated clearly and in a timely manner. The AFM also wants to see that customers with payment problems or an interest rate derivative linked to their business finance are offered a suitable solution where necessary.

Activities in 2016

- Promoting the provision of clear information that supports good decision-making by banks to small business customers regarding their lending products and services;
- Promoting assistance to small business customers with payment problems in the form of appropriate solutions;
- Promoting the principle that interest rates charged for bank lending products and services are justifiable and clearly communicated by the banks in a timely manner.

Effect within 3 to 5 years:

- Small business customers can justifiably have confidence in the market for business finance;
- Financial enterprises give central priority to the interests of small business customers in the services they provide.

There will be a review of whether our priorities in this theme need to be adjusted or added to on the basis of developments with respect to the interest rate derivatives issue.

Theme 'Consumers are offered comprehensible and efficient pension products'

Objective

Pension consumers are offered comprehensible and efficient pension products that meet their needs.

This theme concerns the lack of understandable communication on pensions. It also concerns the problem of less than optimal pension schemes and products. We will use the criteria of cost-effectiveness, usefulness, safety and comprehensibility in our analysis of whether products or schemes need to be adjusted.

Activities in 2016

- The activities for this theme are still to be established.

Effect within 3 to 5 years:

- Institutions provide their scheme members with comprehensible and balanced information on their pension scheme and/or pension product;
- Pension products meet the needs of scheme members. The contribution should result in the highest possible pension benefit while avoiding irresponsible risks.

3.1.3 Quality of Auditing and Reporting Division

This division has the following objective: *The AFM considers good quality auditing and reporting to be essential.*

The AFM monitors whether auditing and reporting complies with regulation and the expectations of the public. Good quality reporting by listed companies is essential. When public expectations change, for instance with more emphasis on the financial and non-financial implications of ecological, social and governance (ESG) factors on the business operation, the reporting by listed companies and financial institutions must reflect this and be sufficiently comprehensible to an ever-increasing and more critical group of stakeholders. Our supervision is designed to contribute to an environment in which investors can rely on the quality of the information presented and make informed choices on that basis. This division is responsible for *supervision of financial reporting, supervision of audit firms and provision of policy recommendations in these areas*. The division is also involved in *international forums* such as IFIAR and IOSCO. The AFM will also be responsible for the suitability testing of directors and supervisory directors of audit firms.

The division has identified a risk that is serious enough to warrant a thematic approach. This concerns the risk that audit firms will not sufficiently improve the quality of their statutory audits and that they cannot ensure that improvements are permanent.

Theme 'The quality of statutory audits by PIE audit firms will improve'

Achtergrond	Theme	Scope
• The quality of statutory audits is still not adequate and has not significantly improved in recent years • PIE audit firms are responsible for 66% of the statutory audits performed in the Netherlands	Improving the quality of statutory audits	PIE audit firms

Objective

The objective of this theme is to achieve a significant improvement in the quality of the statutory audits of financial statements by PIE audit firms. Since PIE firms perform two thirds of all statutory audits, the AFM focuses specifically on this group. Due to the impact of the Big-4 audit firms, this is where the focus will be in 2016. We expect to devote more attention to the other PIE audit firms in 2017.

Fundamental changes are needed to improve the quality of statutory audits and ensure that these improvements are permanent. Governance plays an important part here. The importance of statutory audits in the public interest has to take central priority to ensure that users such as investors, pension scheme members and consumers can regain confidence in the audit opinions issued. The effect that we wish to achieve in our measurements of the quality of PIE audits is to reduce the number of inadequate audits on each measurement occasion (in the cycle).

Activities in 2016

- Conducting a second measurement at the Big 4 audit firms. The scope of the sample of the audits to be tested will to some extent depend on the available capacity in 2016. This could mean that the reporting of the findings will be made in the first quarter of 2017.
- A baseline measurement of the effectiveness of change measures at PIE audit firms.

Effect within 3 to 5 years:

- Only a limited number of the statutory audits performed by PIE audit firms will be of inadequate quality;
- In 2018 the PIE audit firms will have implemented all the measures of the NBA and the recommendations of the AFM in the report on the Big 4 firms of September 2014.

3.1.4 Market Integrity and Enforcement Division

This division has the following objective: *The AFM reduces the effect of serious violations and contraventions by parties in the financial markets to a manageable and acceptable level*

The AFM is responsible for combating serious violations and contraventions in the financial markets, such as the offering of financial services without a licence to do so. Since this behaviour takes many forms and is constantly changing, it is important that we continue to develop so that we can identify instances in good time and take preventive action. The division's responsibilities include *investigation of abuses by illegal and exempt parties, (co)policymakers of licensees and licensees that commit offences*. This division is also responsible for *monitoring and dealing with recidivists and repeat offenders,* and it *investigates licensees engaged in money laundering or the financing of terrorism*. The supervision carried out by this division also focuses on raising the awareness of the relevant financial institutions regarding the risks and their reporting obligations.

The division also maintains contact on behalf of the AFM with other supervisory agencies relating to the Wwft, the Public Prosecution Service, the Dutch Financial Intelligence Unit and the Ministry of Finance on this issue.
The division has identified two risks that are serious enough that a thematic approach is called for. The two themes for this division are described below.

Background	Theme	Scope
• Consumers are not giving proper consideration to risk and return due to the low level of interest rates, and have a tendency to follow the herd • This creates opportunities for unethical or ill-intentioned parties and leads to serious violations and contraventions	Unethical earnings models will be dealt with	Advisers, intermediaries, portfolio managers and unethical borrowers
	Irresponsible lending will be dealt with	Providers of consumer credit, intermediaries and unethical parties

Themes for this division

Theme 'Unethical earnings models will be dealt with'

Objective

The AFM will deal with earnings models that are not in the interests of consumers, investors and SMEs. The primary focus will be on the market for investments. This includes earnings models of legal and illegal parties with high costs and low returns for consumers and investors.

The low interest rate environment means that investment is the only remaining option for consumers and investors to accumulate capital. Due to the low level of interest rates, consumers and investors are not making a proper assessment of risk and return, and are tending to emulate the choices of the majority, meaning that large numbers of them are making investments that do not correspond to their perceived level of risk. This is therefore a market that offers good opportunities for ill-intentioned parties to make money quickly and easily at the expense of consumers, investors and SMEs.

Activities in 2016

- Designing and embedding the identification function;
- Identifying unfair earnings models of both licensees and non-licensees, and identifying trends;
- Investigating illegal and exempt parties with unfair earnings models and enforcement.

Effect within 3 to 5 years:

- Market parties with unfair earnings models will be dealt with;
- Mis-selling and product pushing or the misleading of consumers, investors and/or SMEs in the investment market will be reduced;
- Consumers are offered appropriate advice when switching an insurance product to a capital accumulation product;
- The number of consumers with undesirable capital accumulation products will be reduced or limited.

Theme 'Irresponsible lending will be dealt with'

Objective

The AFM urges market parties not to lend irresponsibly and will act against ill-intentioned parties.

There is a large and growing problem in relation to debt in the Netherlands, whereby one in six Dutch households is exposed to risk of getting into difficulty with debt, is already experiencing such a problem, or is in a debt counselling process. This problematic debt is partly due to excessive lending. The legislature wishes to combat this phenomenon by means of specific standards applying to consumer credit, such as awareness and responsibility regarding lending, the prevention of pushy behaviour, and measures to address the issue of excessive charges. These principles are still commonly violated by market parties engaged in serious *violations and contraventions*.

Activities in 2016

- Review of pay-day loans, credit for goods, interest-only loans (locked up), private leases, crowdfunding, overdrafts at high interest rates and debt collections;
- Identifying the risks relating to consumer credit (scale, losses and players) and identifying the various manifestations thereof;
- Investigation of the various lending standards.

Effect within 3 to 5 years:

- Behaviour by market parties that leads to the prevention of irresponsible lending (actual or implied);
- Harmonisation of various standards, such as the NVB standard, the NTO standard and the VFN standard;
- Credit products offered or recommended are appropriate to the customer's situation;
- Products or constructions that meet the same demand as consumer credit but are not treated as such by law are either subject to supervision or have been removed from the market.

3.1.5 Asset Management Division

The role of asset management is growing, and becoming more international and more complex. At the same time, asset management is increasingly important as a source of finance for businesses and for capital accumulation by Dutch households. We have decided to form an Asset Management division in order to supervise this area as effectively as possible. All the knowledge and expertise relating to asset management within the AFM can be combined in this division in order to offer an adequate response to the developments in this area.

The division will focus on the management side of asset management for institutional and retail investors and on the distribution side for institutional investors. This concerns collective and individual asset management and the MiFID services *'individual asset advice'* and 'execution-only'. The division's responsibilities include *licensing, supervision of ongoing obligations of asset managers, and account management of division-specific asset managers and depositaries. In addition, its responsibilities include personal testing in relation to the division's scope, risk analysis of relevant signals, and data reporting.*

On the basis of a risk analysis, the AFM has identified a number of areas it wishes to address in its supervision. In addition to continuing attention to licensing and fund reporting, the supervision will also be risk-driven.

- The division will focus on internal governance, the quality of the investment process, the depositaries of collective investment schemes, segregation of assets and the valuation of funds;
- The division will focus on the distribution process, the provision of information, and critical awareness at institutional investors.
- It will also focus on the 'maturity' of the entire population of asset managers in the market, the extent to which there is an alignment of interest, and whether parties have their organisations in a proper condition so that investors can invest their capital with confidence.
- The division will identify vulnerabilities that could lead to serious disruption or impact, such as 'bubble' forming, the leverage models chosen, and liquidity risks.
- A number of exploratory reviews will be carried out to determine which themes should take priority within this scope.

The new Asset Management division started operations in January 2016. The themes will be further defined in due course.

3.1.6 Innovation Programme and Fintech

The influence of technology has brought about drastic changes in the financial markets which have accelerated in the past year. The increasing availability of data in combination with techniques to convert these data into usable information also means that more complex functions are now being automated. This applies for instance to investment analysis and the provision of investment advice, the assessment of credit and loss risks, and the sale and distribution of financial products. Advanced identification, authentication and encryption techniques moreover make it possible to bypass links in the chain -links that for now are essential to ensure the level of confidence that is needed for a healthy market. This change in the market structure is being driven by both the supply side (fintechs) and the demand side (consumers and investors). Technology will also accelerate the internationalisation of retail markets.
The Innovation & Fintech programme is designed to ensure that the AFM accommodates innovation in the financial sector, to the extent that this contributes to sustainable financial well-being in the Netherlands. The programme also will ensure that the risks relating to these innovations are addressed.

The Innovation and Fintech programme will generally focus on the following activities:
- Creating an overview of innovative and fintech concepts and their impact on the sector and the AFM.
- Accommodating innovative players by addressing problems and reducing unnecessary barriers.
- Making the legislative framework and legal interpretations appropriate.
- Preparing the AFM organisation for the fast-moving market conditions.

3.2 Priority 2: Strengthening supervision through investment in technology and methodology

Expertise Centre

Technological developments affect the AFM as well as the financial sector. We can work more effectively as a result of the availability, analysis and application of data. New insights into consumer and investor behaviour and the behaviour and culture of organisations also mean that our supervision is becoming more effective.

The AFM has set up an Expertise Centre in order to ensure that new insights can be incorporated into our supervision. The three focus areas are described in more detail below.

Focus element 1: Consumer and investor behaviour

Increasing our knowledge with respect to consumer and investor behaviour will strengthen the effectiveness of supervision. We know from behavioural studies that consumers and investors frequently do not act rationally. Greater knowledge and understanding of consumer and investor behaviour will help us to identify risks and make our interventions more effective.

The AFM will focus mainly on influencing the sector for two reasons. The AFM has a statutory supervisory mandate with respect to influencing the sector, but this does not apply to influencing consumers and investors. Research in this area moreover suggests that influencing the decision-making environment is more effective than influencing consumers and investors themselves. Influencing the decision-making environment will over time lead to better results for consumers and investors.

The Expertise Centre represents an investment in the accumulation of more knowledge and knowledge-sharing in the field of consumer and investor behaviour.

Actual activities in 2016

- Research;
- Exploratory reviews in cooperation with providers and other parties;
- Influencing legislation from the perspective of consumer behaviour;
- Developing new supervisory instruments.

Focus element 2: Behaviour and culture

The AFM strongly supports an organisational culture at financial markets parties and sectors in which fair and transparent provision of services is encouraged. Increasing our knowledge with respect to behaviour and culture will strengthen the effectiveness of supervision. Research shows that problems in the behaviour and culture of an organisation are a forerunner of abuses in products and service provision. Greater knowledge and understanding of behaviour and culture within organisations (and sectors) will help us to identify risks and make our interventions more effective.

At the Expertise Centre we are developing instruments and methodologies in order to gain better and timelier insight into undesirable behaviour at financial enterprises. In addition, we are carrying out structural research into the organisational culture at enterprises falling under our supervision, in order to improve our insight and thereby apply appropriate interventions. We also support projects relating to difficult problems that aim to expose the root causes of the behaviour in question. The Expertise Centre is intended to improve knowledge and expertise with respect to behaviour and culture and the use of this in our supervision across the AFM.

Actual activities in 2016

- Thematic and other reviews;
- Development of new supervisory methodologies;
- Increasing knowledge and expertise with respect to behaviour and culture.

Focus element 3: Data-driven supervision

Financial markets increasingly operate on the basis of data and automated processes. As a supervisor, this also presents us with the opportunity to use the data available. The AFM already collects and analyses data, however the Expertise Centre will give further shape to our ambition of becoming a data-driven supervisor. Where possible, we will do this in concert with DNB.

Actual activities in 2016

- Data collection in order to improve the information position;
- Data analysis for more defined signalling of risks;
- Visualisation of data in order to arrive at deeper insights.

3.3 Priority 3: Increasing the effectiveness, efficiency and adaptability of the internal organisation

To be able to react in an alert manner to the external challenges that the AFM has to deal with, changes are needed to our internal organisation as well. In 2016 we will therefore invest in increasing the effectiveness, efficiency and adaptability of our organisation and staff. There are three central areas of development planned for 2016: strengthening the management, making our operation more professional, and reporting. These are explained further below.

Strengthening the management

We will invest in the further definition and design of the governance model of the AFM in 2016. We will also invest in further development of the leadership qualities of our people.
Leadership means firstly the ability to manage based on results and discipline, and secondly the ability to possess self-reflection, a sense of responsibility and the ability to empathise. Especially in times of change, it is important that the management sets a good example. Education, continuous training and coaching contribute to this. As a supervisory authority in the complex financial sector, it is also important to attract talent with competitive employment benefits, to provide professional guidance to these people, and to retain them for the organisation.

Diversity is an important item of attention in the recruitment policy for new staff. Like any organisation, the AFM benefits from dissenting opinions and counterbalance. This is the only way to avoid tunnel vision and ensure that we remain focused. We organise discussions at every level because we are convinced that this produces the best decisions. In practice, this means that we are always looking for a composition of people with different (cultural) backgrounds, skills and expertise.

Making our operation more professional

The business operation of the AFM supports and facilitates supervision and the long term objectives of the Multi-Year Agenda. It is the foundation on which our organisation stands and upon which we can build further. We see discipline as the key word here, especially with respect to cost control.

For the coming year, this means that we will structure the management cycle, planning and processes on the basis of efficient and secure information systems. This applies to account management, the signalling of risks and the recording of data. Where possible we will simplify our operational processes, combine strengths and avoid duplication. Among other things, we will follow the Lean Six Sigma method to achieve this. The AFM is also involved in an IT programme in which we are making focused investments in accelerating solutions to legacy problems. Over time this will lead to a reduction in our overheads.

Reporting

For a supervisor like the AFM, our social mandate is just as important as our contact with our stakeholders. Not only because this promotes mutual understanding, but mainly because as a supervisor this keeps us up to date with new developments. There will therefore be greater continuity and focus applied in the contacts with market parties, and stronger direction from the management. There will also be continuing attention to offering insight into our activities to the outside world.

4. Finance

This section deals with the consequences of policy for our budget. We then turn to the key figures, the costs per type and the investment budget. We conclude with a description of how the AFM is funded.

As described in section 2 'Vision of changing supervision', the AFM has set itself a challenging objective for 2022 of becoming a *demonstrably ground-breaking supervisor*. To speed up the implementation of the necessary changes, the AFM will make investments over the period from 2015 to 2017 designed to reduce its cost base in the subsequent years, assuming that there are no additions to its mandate.

In 2015, the AFM intensified aspects of its supervision and introduced some initial changes. In 2016 it will make serious cuts in certain areas in order to make additional investments in new areas and to arrive at an appropriate budget. These strict decisions have made EUR 6.7 million available for the realisation of our ambitions. The dilemma here is to invest in renewal while at the same time devoting sufficient attention to mitigating existing risks and addressing new tasks.

The intensifications are occurring in the following areas:
- Additional commitment to the supervisory areas of asset management, consumer behaviour, behaviour and culture and FinTech (EUR 1.8 million)
- Investments in IT in relation to data-driven supervision and rationalisation of the IT infrastructure (EUR 1.6 million)
- Change processes that will lead to increased effectiveness, efficiency and adaptability of the organisation (EUR 3.3 million)

The necessary changes will be funded by the following measures:
- More limited commitment in the supervisory areas of Retail, Capital Markets, Market Integrity and Enforcement and with respect to the international agenda (- EUR 2.8 million)
- More limited commitment from supervisory support departments (- EUR 0.7 million)
- Reduction of regular hiring of external staff, consultancy expenses and other savings (- EUR 2.7 million)
- Temporary cessation of new intake in the AFM trainee programme (- EUR 0.5 million)

4.1 Key figures

The total budgeted expenses are 6% higher than in the budget for 2015. The higher expenses are mainly due to higher costs of informationprocessing, higher employee expenses and higher general expenses. The budgeted average workforce will remain more or less unchanged in 2016.

Key figures	Budget 2015	Half-year reporting 2015	Budget 2016	Difference compared to B2015	Actual 2014
Total expense	87,2	87,2	92,2	6%	80,9
Average number of FTE (incl. external hires)	610	609	609	0%	571

Table 4.1.1: key figures (*EUR 1 mln.)

In its arrangement for the financial supervisors, the Ministry of Finance has included a cost framework for the period 2013-2016. The cost framework was established in law on 1 January 2015. The AFM cost framework for 2016 is EUR 92.2 million. A breakdown of this figure is given in the appendix. The increases in the cost framework resulting from changes to the mandate amounting to EUR 0.9 million have been approved by the Ministers on condition that the related parliamentary bills are passed by the Dutch parliament in 2016. The total budgeted expenses of EUR 92.2 million are equal to the figure in the cost framework.

Deployment of FTEs

The table below shows the deployment of the FTEs in supervision in 2016. The deployment from the other departments relates to supporting activities such as policy work, legal affairs and communication. In addition, this FTE figure includes the operational and staff departments, as well as the Executive Board.

Average number of FTE (incl. external hires)	**Budget 2016**
Efficient Capital Markets Division	58
Retail Division	78
Quality of Auditing and Reporting Division	49
Market Integrity & Enforcement Division	42
Asset Management Division	25
Innovation & Fintech Programme	5
Expertise Centre	47
Account Supervision	20
Supervision Service Centre	29
Subtotal	**353**
Other departments	256
Total	**609**

Table 4.1.2: average number of FTEs (incl. external hires)

4.2 Expenses per type

The table below shows the breakdown of expenses by type.

Expenses per type	**Budget 2015**	**Half-year reporting 2015**	**Budget 2016**	**Difference compared to B2015**	**Actual 2014**
Salary expenses	*46,2*	*45,3*	*48,4*	*5%*	*42,6*
Social insurance contributions	*6,2*	*5,8*	*6,1*	*-1%*	*5,7*
Pension expenses	*8,3*	*9,1*	*9,5*	*14%*	*8,0*
Externa	*1,3*	*3,1*	*1,6*	*22%*	*2,4*
Other employee expenses	*4,0*	*3,7*	*3,8*	*-6%*	*3,5*
Employee expenses	66,0	67,1	69,3	5%	62,3
Premises costs	5,1	5,1	5,1	0%	4,9%
Consultancy expenses	3,8	3,5	2,8	-26%	2,8
Incidental expenses change of pension provider	-	0,1	0,5	-	0,2
IT expenses	4,0	4,5	5,1	27%	5,2
General expenses	5,6	4,9	6,7	19%	3,4
Depreciation	2,5	1,9	2,6	2%	2,0
Financial income and expense	0,1	-	0,0	-168%	0,0
Total expense	**87,2**	**87,2**	**92,2**	**6%**	**80,9**

Table 4.2: expenses by type (*EUR 1 mln.)

The most important developments in the expenses per type in comparison to the budget for 2015 are explained below:

- Employee expenses are 3.3 million higher. This is mainly due to:
  - Higher salary expenses (+ 2.2 mln.) as a result of collective and individual salary increases based on the existing remuneration policy and the effects of a change to tax legislation
  - Lower social insurance expenses (-0.1 mln.) because the statutory percentages for social insurance were lower in 2015 than the percentages used when formulating the budget for 2015.
  - Higher pension expenses (+ 1.2 mln.) as a result of lower interest rates and requirements pursuant to the new Financial Assessment Framework.
- Consultancy expenses are 1.0 million lower. The reduction is due to a number of strict decisions intended to create more room in other types of expense.
- The incidental costs of the transfer to a new pension provider are estimated at 0.5 million. This concerns the expected transfer and liquidation costs associated with the move to a new pension provider as of 1 January 2017, which will lead to reduced administration costs in the future.
- Expenses relating to information technology are 1.1 million higher. The increase is mainly due to:
  - The development of new IT systems that are needed for new European directives (MiFID II, MiFIR, EMIR, etc.);
  - The development and purchase of software to enable analysis, correlation and visualisation of large collections of data sets;
  - The compliance with stricter requirements in relation to IT security.
  - General expenses are up 1.1 million. The increase is due to a reserve formed for increasing the professionalism of the organisation. In 2015-2017, the AFM will invest in strengthening its supervision and increasing its organisational efficiency and effectiveness.

4.3 Investment budget

Investments	Budget 2015	Half-year reporting 2015	Budget 2016	Difference compared to B2015	Actual 2014
Rebuilding	0,8	0,7	0,2	-79%	0,1
Inventory	0,4	0,1	0,4	-4%	1,4
Computer equipment & standard software	0,8	1,3	2,6	-221%	1,4
Customised software	1,7	0,7	1,0	-41%	0,3
Total investment	**3,7**	**2,8**	**4,2**	**12%**	**3,2**

Table 4.3: investments (*EUR 1 mln.)

The total investment budget for 2016 is 0.5 million higher than in 2015 (3.7 million). A number of changes have been made in this budget. The investment associated with 'renovation' is lower, since one-off changes were made to the offices in 2015 to improve the climatic conditions. The investment in computer equipment and standard software, on the other hand, is higher, since there will be investment in the modernisation of the IT infrastructure in 2016. The investment in customised software is lower, since applications developed in the ESMA context will be used for new supervisory activities, while the 2015 budget was based on the development of a proprietary system. The standard depreciation term for renovations is equal to the remaining term of the lease, and is five years for inventory and three years for computer equipment and software.

4.4 From budget to levies

Since 2013, the AFM's total costs have been funded on the basis of the Financial Supervision (Funding) Act (Wet bekostiging financieel toezicht, or 'Wbft'). 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 Money Laundering and Terrorism 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 funding on the basis of the Wbft and the funding for supervision of the BES Islands.

Total expense	Budget 2015	Half-year reporting 2015	Budget 2016	Difference compared to B2015	Actual 2014
Expenses Wbft	86,9	86,9	91,8	6%	80,7
Expenses BES	0,3	0,3	0,4	26%	0,3
Total expenses	**87,2**	**87,2**	**92,2**	**6%**	**80,9**

Table 4.4.1: total expenses (*EUR 1 mln.)

The breakdown of the total costs is as follows:

The Financial Supervision (Funding) Act (Wet bekostiging financieel toezicht, or 'Wbft')

The budgeted costs pursuant to the Wbft amount to 91.8 million. The funding of the budgeted costs is shown in the table below.

Operating difference Wbft	Budget 2015	Half-year reporting 2015	Budget 2016	Difference compared to B2015	Actual 2014
Expenses Wbft	0,8	0,7	0,2	-79%	0,1
Market contribution to ongoing supervision	*79,8*	*75,2*	*84,4*	-	*50,4*
Market contribution for non-recurring services	*7,1*	*6,7*	*7,3*	-	*5,9*
Penalties and incremental penalties	-	*0,1*	-	-	*4,8*
Government contribution	-	-	-	-	*20,2*
Income	86,9	82,0	91,8	6%	81,3
Operating difference	**0,0**	**-4,9**	**0,0**	**-**	**0,7**
To be set off from previous years	**n.b.**	**4,6**	**n.b.**	**-**	**4,0**
To be set off next year	**0,0**	**-0,3**	**0,0**	**-**	**4,6**

Table 4.4.2: operating difference Wbft (* EUR 1 mln.)

The government contribution lapsed as of the start of 2015 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 to ongoing supervision

The expenses covered by an annual levy charged to market parties have risen from 79.8 million in the 2015 budget to 84.4 million in 2016. This contribution from the market does not include amounts carried forward from previous years. The increase in the amount levied for ongoing supervision is due to the higher expenses as detailed in section 4.2. For 0.2 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 institutions subject to supervision according to fixed percentages. These percentages are in principle1 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 institutional category on the basis of these percentages are included in the table below and form the basis for the fees for ongoing supervision in 2016.

[1] 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.

Market contribution	% 2015-2017	To be levied 2015	To be levied in 2016	Difference compared to B2015
Credit providers	2,2%	1,8	1,9	6%
Audit firms	10,3%	8,2	8,7	6%
Advisers and intermediaries	21,2%	16,9	17,9	6%
Settlement firms, payment institutions and electronic money institutions	0,1%	0,1	0,1	6%
Banks and clearing institutions	18,4%	14,7	15,5	6%
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%	11,7	12,4	6%
Investment firms engaged in proprietary trading	0,4%	0,3	0,3	6%
Central counterparties	02%	0,2	0,2	6%
Securities-issuing institutions: market	8,1%	6,5	6,8	6%
Securities-issuing institutions: reporting	7,2%	5,7	6,1	6%
Financial infrastructure: market operators and operators of an MTF	2,3%	1,8	1,9	6%
Pension funds and premium pension institutions	3,5%	2,8	3,0	6%
Insurers: life and pensions	8,5%	6,8	7,2	6%
Insurers: non-life	2,8%	2,2	2,4	6%
Insurers: healthcare	0,1%	0,1	0,1	6%
Total	**100%**	**79,8**	**84,4**	**6%**

* The old categories 'Investment firms and providers of investment objects' and 'Investment firms not engaged in proprietary trading, excluding operators of an MTF' have been combined in this new category starting in 2016.

Table 4.4.3: Market contribution for ongoing supervision excl. amounts carried forward from previous years (*EUR 1 mln.)

Market contribution for non-recurring services

The charges for non-recurring services, such as licence applications and the vetting 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 7.1 million in the budget for 2015 to 7.3 million in the budget for 2016.

Penalties and incremental penalties

Income from penalties and incremental penalties is not estimated, however up to a maximum of 2.5 million this is passed on to the overall market through the operational difference.

Government contribution

The government contribution lapsed as of the beginning of 2015.

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 Money Laundering and Terrorism 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 for 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, since the fees are not established on a cost-effective basis.

Operating difference BES	**Budget 2015**	**Half-year reporting 2015**	**Budget 2016**	**Difference compared to B2015**	**Actual 2014**
Expenses	0,3	0,3	0,4	26%	0,3
Market contribution to ongoing supervision	*0,0*	*0,0*	*0,0*	-	*0,0*
Market contribution for non-recurring sevices	*0,0*	*0,0*	*0,0*	-	*0,0*
Government contribution	*0,3*	*0,3*	*0,4*	-	*0,3*
Income	0,3	0,3	0,4	26%	0,3
Operating difference	**0,0**	**0,0**	**0,0**	**-**	**0,0**

Table 4.4.4: operating difference BES (*EUR 1 mln.)

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

Appendix: Composition of cost framework

Cost framework		**2015**		**2016**
Basic amount		86,7		87,2
Change in salaries		1,1		3,3
Change in prices		0,3		0,3
Change in responsibilities		0,3		0,9*
EMIR	*0,3*			
Suitability test for audit firms	-		*0,2*	
Implementation Act statutory audits of financial statements	-		*0,1*	
Mifid II			*0,2*	
Provision of payments services (PAD and MIF)			*0,2*	
Variable Pension Benefits Act			*0,2*	
Costs of changes to European supervision				0,5
Final total cost framework for the year		**88,4**		**92,2**

Table B2: composition of cost framework (*EUR 1 mln.)

*The increases in the cost framework resulting from changes to the mandate amounting to EUR 0.9 million have been approved by the Ministers on condition that the related parliamentary bills are passed by the Dutch parliament in 2016.

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