

*The Dutch Authority for the
Financial Markets*

Annual report 2018





Foreword



Political uncertainty, and especially Brexit, left a mark on the financial markets and our supervision in 2018. The continuing digitalisation of financial products and services also increasingly required our attention. This digitalisation may be in the interests of customers, but it also involves new risks. We also note that there was more demand for the financial sector to show a social compass in 2018, for instance in the public debate over pay.

Brexit

Brexit is causing uncertainty. The Dutch Authority for the Financial Markets (AFM) has to deal with this on a daily basis. We describe this development in [Trendview](#). Trading platforms and other market parties from the United Kingdom are looking to locate in the Netherlands, partly due to its good technical and logistical infrastructure and the quality of supervision. We expect Brexit to bring about significant changes. The position of the Netherlands in the European capital market will be significantly enlarged with the arrival of a large proportion of shares and bond trading. New parties and fast-growing trading pose new supervisory challenges for us. One of the consequences is that we will have to monitor many more transactions. We are accordingly investing heavily in our ICT systems and personnel.

Continuing attention to high debt

House prices have been rising in recent years, and fewer and fewer mortgagees are in negative equity. This is a positive, but also a dangerous development. Consumers could get the mistaken impression that they are richer now. They will therefore be more likely to take on a new and usually more expensive home. This could lead to excess borrowing and problems with mortgage debt. In 2018, we urged mortgage providers to provide information to customers with interest-only and investment-linked mortgages and to urge them to take action.

We see that good economic figures are associated with higher consumer spending. As long as they can afford to do this, problems are unlikely to arise. But borrowing to finance spending should not be automatic, especially when providers do not make it clear that borrowing involves an obligation to repay and to pay interest. Accordingly, in 2018 we ensured that new credit providers operate in accordance with Dutch legislation on consumer credit. Our legislation is stricter than in other countries, due for example to the maximum cost of credit and a ban on excessive lending.





Suitable investment products and services

The ECB policy to encourage investment in the eurozone by reducing interest rates has been successful in recent years. The European economies have emerged from the slump. But the low interest rate at the banks has another side: people are looking for investments offering a higher return.

Not all investment firms communicate honestly with respect to product features and the associated risks. Optimal investor protection is a requirement. Our research shows that there is room for improvement here. We have shared our ideas for improvement with investment firms. They now know how they can improve their product distribution so as to provide investors with better protection.

In addition, at international level we have pushed hard for a ban on products that are presented as safe investment products but which actually are undesirable and high-risk. This has led to a ban on binary options and strict regulation for CfDs.

“We have pushed hard for a ban on products that are presented as safe investment products but which actually are undesirable and high-risk.”

Digitalisation of the financial sector

The financial sector is changing as a result of the increasing number of applications of innovations driven by technology. Digitalisation is leading to new providers, increased data flows and more distribution opportunities. This can generate products and services that are in the customer’s interests. But to what extent is people’s privacy safeguarded and are we sure that the huge volume of data is not being used to influence people in their financial decisions, online or offline? We are also seeing new manifestations of financial cyber criminality. This causes increasing pressure on the gatekeeping role of financial institutions to prevent abuse of the financial system.

In its supervision, the AFM is focusing more on care in the use of customer data, the robustness of value chains that are becoming more complex and the management of risks in IT-intensive business operations. The AFM itself is becoming increasingly data-driven in its own operations, partly through the development of a data platform and various data-driven studies.

We have reviewed conduct and culture at organisations in order to be able to identify risks at an early stage. The challenging condition of the labour market is a cause for concern with respect to the professionalisation of our organisation. Nonetheless, we succeeded in hiring 109 high quality employees.

Improving quality in the audit sector

The AFM conducted a preliminary study into the [‘Vulnerabilities in the structure of the audit sector’](#) in 2018. In our role as supervisor, we wish to contribute to the debate on the sustainable and consistent quality of statutory audits, which is also happening in an international context. Partly due to this report, the Minister of Finance has appointed a Committee on the Future of the Audit Sector.





Reducing the social gap

The financial sector is not an island, it is an inextricable part of society. It must therefore take account of the fact that society quite rightly places demands on it. Trust in the sector is gradually returning, but is still fragile. This can be seen from the reaction to increases in the remuneration of the Executive Board and financial criminality. It is important that companies and their executive directors continue to be engaged in a dialogue with society. Connectedness is relevant, especially for financial enterprises. Unfortunately, there is still too often a gap between the financial sector and the rest of society. Bridging this gap is essential for a company's continuity, and for creating sustainable value. And thus for sustainable financial well-being in the Netherlands. We will continue to support this in our role through the continuous commitment, drive and professionalism of our staff.

On behalf of the Executive Board,

Merel van Vroonhoven
Chair of the Executive Board of the AFM





Management summary

The AFM focused on three priorities in 2018.

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

Risk 1: Loans that are not in the customer's interest

A problematic debt burden constitutes a risk and can lead to financial dependence and social isolation. The AFM believes it is important that providers and intermediaries give central priority to the customer's interests when providing credit.

Interest-only mortgages may also cause financial problems for consumers.

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- + Our efforts to find a permanent solution to the locked-up problem have been successful. We have seen a 73% reduction in the number of locked-up situations at finance companies compared to the first measurement in 2014. At year-end 2018, more than 50,000 customers had been given a suitable solution, giving them the prospect of a debt-free future.
- + Credit providers offering products that encourage excessive borrowing have to change their acceptance policies.
- + Together with DNB, the ECB and the major banks, the AFM has developed a method to segment portfolios of interest-only mortgages according to potential risk. This means that mortgage providers can approach customers who are at risk to explain the structure and risks of their mortgage and show them whether and how they can take action.

Uniform Recovery Framework for interest-rate derivatives

Our [fourth progress report](#) on the Uniform Recovery Framework for Interest-Rate Derivatives (URF) was submitted by the Minister of Finance to the House of Representatives on 31 January 2019.

At the end of 2018, 17,000 of the 19,000 SMEs had been informed of the recovery amount and had received EUR 860 million in advance payments or compensation.

Risk 2: Inappropriate investment products

The increasing demand for investment products and services involves risks. Investors may purchase products that are not suitable for them.

We want to see investment firms improve the quality of their products and communicate honestly and transparently on return, risks and the costs of their products and services.

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- + At European level, we have played a leading role in the formulation and implementation of the ban on binary options and restrictions on CfDs. As a result, several high-risk products have been removed from the European market for retail investors.
- + In advice to the Minister, the AFM and DNB argued for a national licensing system for crypto exchange platforms and providers of crypto custodial wallets in order to combat money laundering and the financing of terrorism more effectively.
- + The AFM has urged investment firms to improve the information on the costs of investment products, so that investors can compare products and services better.
- + We placed nine boiler rooms on the warning list in 2018.





- + Our publications '[Guideline on fulfilling the duty of care with \(semi-\)automated asset management](#)' and '[View with respect to automated advice: opportunities, duty of care and items of attention](#)' provided advice to parties engaged in (semi-)automated asset management with respect to improving investor protection.

Risk 3: Undesirable consequences for markets and supervision from international developments

The financial markets are becoming more integrated. Potentially, the capital markets are becoming more efficient. This can create a better and more diverse offering to consumers. At the same time, we see new risks, such as the risky or fraudulent investment products that are being offered from other EU countries.

Three developments have defined the international context for the AFM in 2018: Brexit, the introduction of new regulation and the acceleration of supervisory convergence in Europe.

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- + Our preparations for the effects of Brexit and our urging of market parties to prepare for this have reduced the risk of market interruption.
- + As the chair of the IPISC, we have contributed to European cooperation in formulating policy on matters including Brexit, data collection and capital market issues.
- + We have raised the level of investor protection through our implementation of (among other things) MiFID II (which is designed to protect investors and the operation of the capital markets) and IDD (the Insurance Distribution Directive).
- + Together with the European supervisors ESMA, EIOPA and EBA, the AFM has more strongly promoted convergence in supervisory methods used by national supervisors. This is leading to a level playing field for market parties.

Risk 4: Irresponsible use of technology and data

Developments in technology and data can deliver benefits for consumers. However, they can also harm the interests of customers. Consumers do not always make decisions rationally. Some investment apps take advantage of this and use persuasion techniques. In addition, vulnerability to digital criminality is increasing. It is therefore important to continue the dialogue with companies subject to supervision on the risks of cybercrime. We also wish to prevent ungrounded trust in cryptos as a means of payment.

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- + In its publication 'Guideline on fulfilling the duty of care with (semi-)automated asset management', the AFM stated what it expects from financial services providers and their IT partners under the quality requirements for automated advice.
- + Based on insights from behavioural scientists and with DNB, the AFM has researched advanced data analysis techniques in the insurance sector, with the aim of establishing principles for the application of these techniques. These principles provide a framework for the application of machine learning by financial enterprises.
- + Research has been conducted into apps that use persuasion techniques. The results can be used to improve these apps.
- + We issued strong warnings on the dangers of cryptos in 2018. One important effect was that not one important financial enterprise has offered cryptos.
- + In addition, various investigations were carried out of parties that have offered cryptos. One of these investigations concerned Dutch Crypto Mining B.V. (DCM). The AFM imposed an order for incremental penalty payments on DCM in order to obtain information on the activities of DCM, so that we could establish whether statutory obligations were being met. DCM was declared bankrupt shortly thereafter.





Risk 5: Insufficient improvement in the quality of audits

Reliable and relevant reporting is important for investors and other users of financial information. However, the quality of statutory audits is not yet permanently assured. The AFM accordingly focused mainly on increasing the quality of statutory audits in 2018 and the structural embedding of improvement measures in order to achieve a high level of quality in statutory audits on a permanent basis. Another priority for us was the testing of executive and supervisory directors of PIE audit firms for suitability.

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- + The AFM report 'Vulnerabilities in the structure of the audit sector' boosted the national and international debate on sustainable and consistent quality of statutory audits at national and international level, leading to the appointment of the Committee on the Future of the Audit Sector by the Minister of Finance.
- + More intense supervision of the other PIE audit firms can help these organisations to raise quality.
- + PIE audit firms for which the suitability testing was completed in 2018 have a board of directors found to be suitable. At the end of 2018, the testing of the directors of six of the nine PIE audit firms had been completed. This involved a total of 51 tests.

Risk 6: Disappointing financial position after retirement

Many people accrue less pension than they expect and are not aware of this. People also do not know what they can do to compensate for or avoid a loss of income. To reduce the risk of a disappointing financial situation after retirement, we devoted attention to better guidance for consumers and employers with respect to choices in relation to pension. We also carry out ongoing supervision under the Pensions Communication Act. We have also reviewed pension products in the second and third pillars that meet the features and needs of the group in question. In 2018 we focused specifically on the effects of the Premium Schemes (Improvements) Act (*Wet verbeterde premieregeling*).

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- + We reviewed the fixed and variable benefit products provided by the five largest pension insurers. At pension funds with defined contribution schemes, we reviewed the quality of the guidance for the provisional choice between a fixed and a variable benefit and the observance of the obligation to obtain information from pensioners wishing to invest independently.
- + We issued guidance to employers on the formulation of their advice with our revised version of the 'Guideline on second pillar pensions advice' (*'Leidraad tweede pijler pensioenadvies'*).
- + Our report 'Freedom of choice and individual arrangements for pension contribution' (*'Keuzevrijheid en maatwerk bij pensioeninleg'*) contributed to the public debate on a new pension contract and greater freedom of choice.

Risk 7: Inadequate risk management in asset management

The asset management sector is growing worldwide, and this is increasing the pressure on the asset management chain. These developments involve the risk that business operations may not be controlled and ethical, and may moreover have consequences for financial stability. This affects the interests of customers and the proper operation of the capital markets.

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- + We have discussed our legislation and regulation with 150 parties from the United Kingdom wishing to relocate in the Netherlands as a result of Brexit. We also emphasised that parties located in the Netherlands must act in the customer's interests.
- + We have indicated to managers with a legally converted AIFM licence how they can better meet the statutory requirements.
- + We sent a sector-wide letter with recommendations for better safeguarding the interests of investors to all Dutch depositaries.





Risk 8: Operation of the capital markets is not leading to the best price

Trading in financial instruments has become fragmented as a result of internationalisation and technological developments. This can mean that price formation is less transparent. This is bad for investors if price formation in the markets deteriorates as a result. We accordingly reminded the players in the chain, from order to settlement, of their responsibility for fair and controlled trading. There was also a focus on transparency in the bond market, so that market parties fulfil their obligations under MiFID II and are more alert to market abuse.

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- + We conducted projects designed to help enterprises subject to supervision deal more effectively with inside information in relation to cybercrime in 2018. We will publish a list of best practices in 2019.
- + We have more possibilities for data and analysis, so that financial enterprises receive fewer requests for data.
- + We have developed new systems for supervisory data together with other supervisors. These systems will lead to lower costs. The mutual exchange of analytical information can also be improved. This concerns cooperation with a number of Scandinavian countries with respect to transaction reporting and with Norway with respect to commodities transactions.

Risk 9: Insufficient focus on sustainability

Insufficient focus on sustainability by the financial sector impacts the long-term sustainability of the Netherlands' financial well-being. Sustainability is becoming a more prominent issue in both the supply of and demand for financial products and services. In 2018, we focused mainly on encouraging further application of integrated reporting by companies. We also called for clarity and transparency with respect to the definition of sustainability for financial products and services and for integration of the theme of sustainability in our supervisory activities.

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- + We encouraged companies to include more non-financial information in their management reporting.
- + We formed a partnership with the French supervisor AMF for sustainability for European supervisors. We also placed the theme of sustainability on the agendas of ESMA and IOSCO and played an important part in the drafting of the [IOSCO statement](#) on the need for issuing institutions (Wtftv) to be transparent regarding sustainability factors.
- + We have obtained greater insight regarding sustainable investing in the retail market and in institutional asset management.

Risk 10: Use of the financial sector for criminal behaviour

Confidence in the financial sector is undermined if companies subject to supervision engage, deliberately or unknowingly, in financial-economic crime or in other unethical activities. This can also lead to serious financial damage for citizens or businesses.

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- + Audit firms without a Systematic Integrity Risk Analysis (SIRA) have started on making an inventory of integrity risks and are taking appropriate measures.
- + We have published descriptions and examples of what constitutes an unusual transaction. The number of reports of unusual transactions by companies subject to supervision has increased from 6 to 78.
- + In the context of money laundering and the financing of terrorism and the Sanctions Act, we sent questionnaires to all investment firms, managers of collective investment schemes and Undertakings for Collective Investment in Transferable Securities (UCITS). We regularly review whether companies comply with all the [requirements](#) under the Money Laundering and Terrorist Financing (Prevention) Act (*Wet ter voorkoming van witwassen en financieren van terrorisme*, or 'Wwft') and the Sanctions Act (*Sanctiewet*) 1977.





Supervisory measures

We apply measures to address supervisory risks. In our approach, we look for a balance between solving existing problems and preventing new problems through interventions, which may include formal measures.

There were 666 interventions that were more influential in nature in 2018 (450 in 2017). Examples of this are warning letters to persons and companies that failed to submit their notifications of short sales, director's notifications or other important notifications on time. There were 80 interventions involving a formal measure in 2018 (81 in 2017). These included 9 fines amounting to €3.2 million (2017: 12 fines amounting to €4.1 million). We apply this instrument on a targeted basis. The conduct of the offender and the effect of the offence play an important part in this.

In addition to the imposition of administrative fines, we paid attention to relevant appeal cases in 2018. In August 2018, the former directors of Imtech, Van der Bruggen and Gerner, were ordered by the court to pay administrative fines. We also addressed the unfair trading practices of the Nederlands Innovatiefonds (NIF). The AFM imposed an order for incremental penalty payments on its director Ruben Wolf.

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

We further strengthened and renewed our supervision in 2018 through the development of specific areas of expertise, including data analysis. We further embedded data-driven supervision, for instance with the establishment of a data platform and our Data-Driven Supervision training programme. The level of knowledge with respect to data and the various applications of data has been increased throughout the organisation.

We devoted extensive attention to better understanding the underlying causes of risks in the financial sector. This included reviews of conduct and culture at financial enterprises, for instance at audit firms. This provides better insight into what drives people to put the customer's interest or public interest first. This enables us to recognise risky behaviour before it does harm.

We also invested in the early identification and analysis of changes and the associated risks in the financial sector in 2018. Among other things, this led to a supervisory strategy for cyber criminality.





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

Issues relating to insight into costs, legitimacy and effective procurement were resolved in 2018. We remained well within the government-wide tolerance level (2% of actual costs) for unjustified procurement in 2018. We also further strengthened our ICT capability. The AFM made a start on its ambitions with respect to outsourcing and the further digitalisation of processes.

A Future Leadership Programme has been initiated for the development of result-oriented and personal leadership. And, despite challenging conditions in the labour market, we recruited 109 new colleagues in 2018.

Reprioritisation

We have reprioritised certain activities on a risk-driven basis due to the imminent Brexit and the shortage of personnel. Some activities were discontinued, and some took more time to complete than planned.

A project for obtaining greater insight into fees and costs charged by asset managers was not pursued. In addition, our review was restricted to asset managers that do not adequately comply with legislation and regulation.

The MiFID II review of the quality of services provided by investment firms also started later than planned. Feedback is expected in 2019. Furthermore, the review of the progress of change processes, quality safeguards and the quality of statutory audits at the other PIE audit firms has been delayed. The report is scheduled to appear in the autumn of 2019.

Financial

The operating surplus in 2018 came to €5.4 million, due to lower expenses (€-4.0 million) and higher income (€+1.4 million) than estimated. The underspend of €4.0 million represents 4% of the total budget of €98.7 million. Salary, social insurance and pension costs were €2.9 million lower than budget, partly due to on average fewer FTEs (9) than budgeted (vacancies were open for longer) and partly due to outflow of employees at relatively high levels in their salary scales, which led to a lower average for employee expenses. The higher income was mainly due to income from administrative fines and orders for incremental penalty payments of €1.8 million that were not budgeted. Under Section 7 Wbft, with effect from the 2015 financial year, the AFM has to pay income from administrative fines and orders for incremental penalty payments of more than €2.5 million per year to the government. This income was below that level in 2018. The sum of €1.8 million will be fully set off in 2019 in the levies for ongoing supervision.

A sum of €5.8 million will be deducted from the levies in 2019, which consists of the operating surplus in 2018 of €5.4 million and a positive sum to be set off of €0.4 million from 2017.

The AFM had frequent discussions with the Ministry of Finance regarding the budget for 2019 and the impact of Brexit on supervision towards the end of 2018. The Minister approved the addition of an extra flexible budget to the existing cost structure for 2019 and 2020, specifically earmarked for Brexit. This amounts to an additional flexible budget of €7.7 million in 2019. We will report regularly on this to the Ministry of Finance.

The group transfer of pension benefits to De Nationale APF was effected on 1 January 2018 as planned.

The AFM pension fund in liquidation is engaged in completing the liquidation and this is expected to be completed in mid-2019. The surplus in the contribution and the much lower administration costs will be added to the contribution and indexation deposit. The costs per scheme member will decline significantly as a result.

