

## Amsterdam Propriety Traders Managers Meeting

Amsterdam, May 12 at Koninklijke Industriële Groote Club

Speech by **Paul-Willem van Gerwen**, Head of Capital Markets and  
Transparency Supervision AFM

- Ladies and gentlemen. Thank you for inviting me to speak on this occasion.
- I read on the invitation the theme is improving market structure and fostering a solid business climate. In which case, it makes perfect sense to invite a regulator to speak.
- Ensuring that your growing business activities go hand in hand with a safe market. That's what we call a win-win situation.
- And so this won't be about pointing fingers. Well, maybe once or twice.
- Above all, I'm keen for us to look together at where the opportunities are.
- Some of you may well have attended Trading Amsterdam last month, where my colleague Hanzo van Beusekom spoke on the new phase that the Dutch capital markets, and so also the European capital markets, have entered.
- With the FCA having left the EU battlefield, the AFM feels more responsible than ever when it comes to ensuring that these capital markets retain their transparency, robustness and integrity.
- A responsibility that you're feeling too, I hope and believe so.
- After all, there are enough topics that – each in their own way – can have a considerable impact on the way the capital markets function.
- I'd like to run through a few of these with you today:
  - Crypto derivatives

- Integrity
- Internationalisation

### **Section crypto derivatives**

- The first point that I'd like to touch on pertains to the rise and impact of crypto derivatives.
- I'll then move on to Distributed Ledger's impact on clearing.
- First up, crypto derivatives, then.
- Will (founder of Acuiti and host), I saw that you guys regard trading in crypto derivatives as exciting. Time for the finger wagging I promised..
- You could say in general that the development of crypto derivatives has at least caught our eye.
- These are popular products. That said, we do regard such trade as entailing risks. Such as lack of transparency, market manipulation and (other) forms of criminal activity.
- We note that providers are proclaiming these derivatives to be a new tool and a new indicator of the eventual acceptance of the crypto market. The idea being that trust in the crypto market will grow the more tools there are for that market.
- But is that line of reasoning justifiable?
- The popularity of these derivatives is on the rise, but the markets differ markedly in terms of their maturity. There are regulated markets in which we even see central clearing of crypto derivatives. But in general the crypto derivatives market hasn't yet reached the same level of maturity as the other derivatives markets.
- And although, as you put it, the markets are exciting and fast-growing, they're also highly volatile and fraught with risk. After all, in the case of price changes – which can be extreme when it comes to cryptos – the question is whether the parties to the derivative transaction will be in a position to fulfil their promises, as we saw recently.

- I maintain that the trade in crypto derivatives should be restricted to wholesale trade. We have seen the positive impact of electronic market makers on the equity markets by reducing spreads, lowering volatility, increasing resilience. Is this something that could work for the crypto markets as well?
- Don't get caught up in the excitement of this trading, don't let yourself be tempted into retail trading. As you know, the FCA has already banned the sale of crypto derivatives to retail investors. We haven't done so, yet.
- Cryptos and derived tools aren't yet suitable as a means of payment and/or investment. We issued that warning as far back as last March.
- Besides crypto trading, we're also looking at the technology being used for trading and settling some of these crypto products. In other words, at Distributed Ledger's impact on clearing.
- Distributed ledger technology enables users and systems to record transactions using cryptography in a decentralized digital database. Within such a database the information is stored at multiple locations and available at any point in time.
- In DLT systems, there is less need for a central authority as participants in the system communicate directly with each other (peer-to-peer network). The best known example of a DLT system is the blockchain used to trade and settle Bitcoin transactions.
- I know, true believers of crypto's will say there is no need for a central authority within a DLT system. It probably won't surprise you to hear that I don't share that opinion. 'Less' doesn't mean 'none'.
- Because what we know for sure is that within DLT systems there is a need for setting certain rules for the access of participants, for access of products to trade on the system and need for trading rules. For keeping the system up and running.

- To put it simple: Who are you going to call when a transaction isn't executed the way it should have been?
- Our experience so far with DLT, used by regulated entities to trade and settle tokenized financial instruments, remains limited. But we are open to discuss practical use cases with the market.
- We therefore welcome the Commission's proposal for the DLT Pilot Regime to gain more insight in the use of DLT.
- While the proposal is primarily focused on market infrastructures such as trading platforms and CSDs, the AFM would like to encourage you to take part in DLT pilot cases. After all we believe markets function better with market makers.
- This automatically raises the question of what role you could take on.
- A question that's more complicated than it might seem. Because in principle proprietary traders don't get involved in clearing.
- And yet the technological developments could lead to a situation in which a peer-2-peer model arises, with proprietary traders possibly starting to engage in clearing themselves. Then we'd expect the proprietary traders to correctly live up to the responsibilities befitting a clearing institution.
- Whatever the outcome... it's not unlikely that DLT will result in a greater degree of efficiency in the market when it comes to the number of parties required to make or settle a transaction from start to finish.
- This might drive down transaction costs throughout the chain. And if the costs come down, proprietary traders could benefit.
- What can you expect from the AFM? We deem it important for the markets that we regulate to be characterised by robustness and integrity. That the markets are efficient.

- This is why, through our DLT pilot, we're giving MTFs and CSDs the option of providing their services via DLT in our experimental sandbox environment. But we also call upon you to participate in those projects to gain insight.

### **Section Integrity**

- Safe trading in derivatives, safe DLT... it's important for the quality and robustness of the capital market.
- As is a controlled remuneration policy.
- This may be a much-debated topic for you. Never too much, though. Particularly not if you're inviting a regulator to speak..
- So, briefly. What's going to happen and when?
- Since October 2021 the Investment Firm Directive (IFD) and the Dutch Regeling Beheerst Beloningsbeleid (RBB) have been in effect. They have implications for remunerations and governance.
- It involves not only organizational rules with the setup of a remuneration policy, but for the larger firms also around the publication of payments for certain staff.
- The requirements have actually been in effect under CRD for many years, but were not specifically designed and tailored for investment firms. This has now been done.
- So what have we done so far?
  - With the implementation of IFD and RBB, the AFM is the designated supervisor for the regulations regarding remunerations. It is important for us to know the challenges for your firms.
  - We have therefore spoken with APT and its representatives about these regulations on a number of occasions. The

main topics were the deferred payment of variable payments and the payment in financial instruments.

- So what are our thoughts so far following several consultations?
  - The AFM understands that the regulations carry significant operational consequences, especially for firms with a balance sheet of more than 100 mio Euros. These firms will need to set up a structure where deferred payments which are above a certain threshold can no longer be done in cash, but in financial instruments. Also, a risk and remuneration committee will need to be set up.
  - The AFM is aware that there are still one or two open topics regarding the risk and remuneration committee. AFM and DNB are working on a publication on this topic which should hopefully be released shortly.
  
- What do we expect from you?
  - Despite these challenges, the AFM expects you to continue the implementation. Similar requirements have been in effect for other financial institutions through CRD III and IV for many years and lawyers have grown to be knowledgeable in the main areas.
  - Ensuring a sound implementation of the regulations is also in your own interest. You are well aware that the topic of remuneration is a sensitive one for your sector. For example journalists will be keen on detecting any shortcomings from your side in this area.
  
- We are aware that the implementation of IFD has a significant operational impact on firms. It requires in many cases the setup of a new corporate structure, new labor contracts with employees and hiring of supervisors. All within a relatively short time span.
  
- In order to provide firms with a reasonable time window for the implementation, the AFM has decided to give low priority to the supervision of the topics of deferred payments and payments in

instruments. However, the AFM expects firms to be fully ready from the start of 2023.

### **Section internationalisation**

- Which brings me to my final point for today. But by no means the least important one. Indeed, it'll be one of the greatest challenges for the next few years. Creating the Consolidated Tape.
- Let me repeat again. Transparency is key in ensuring that markets are fair, sound and efficient. Hence we strongly advocate the implementation of a consolidated tape for equity and bonds.
- We believe a consolidated tape will result in less fragmented price information, as well as other relevant information, in the European markets.
- Because market information in the EU is currently (too) fragmented.
- A CT will also help in creating a real European Capital Markets Union, improve the level playing field and will improve opportunities for monitoring execution quality (best execution) for market participants and investors.
- There are numerous ways to waive or defer transparency, and we have ongoing debates about data quality, reference data and ambiguity around reporting instructions for pre and post-trade data.
- At the same time, we have to be ambitious and let perfect not become the enemy of good while keeping the overall goal of the CT in mind.
- The CT is not aimed at jeopardizing or competing with current data franchises; it is about getting the right level of transparency through consolidation of price and transaction information in the EU markets and providing better insights in execution quality for investors. Nothing more, more nothing less.

- I am convinced that through the numerous use cases we have identified, the CT will bring benefits for all types of market participants, be it trading venues, sell side, buy side and retail investors.
- In our MiFIR review, we proposed a series of transparency improvements to work towards meaningful transparency and lay the foundations for a consolidated tape.
- We are therefore pleased to see that the consolidated tape is at the heart of the European Commission's MiFIR review proposals and are hopeful that that the co-legislators agree on the regulatory framework later this year.
- But as always, the devil is in the detail.
- Key is that during the creation of the CT all stakeholders are involved with different preconditions concerning data quality and standards, a feasible commercial model, governance and so on.
- And by stakeholders I also mean you.
- We are therefore pleased to see the high level of stakeholder engagement on the CT and an emerging consensus on the need of a CT.
- We have six fintechs in our innovation hub that have developed CT proof of concepts. We are working with the sector to look at data quality issues for the bond CT in detail, have recently agreed on high principles and aim to do that for other asset classes as well.
- We are confident that a CT will emerge within the next two years if we get it right. Now is the time to deliver.

Ladies and gentlemen,

- We now find ourselves in the capital markets 2.0, in part due to Brexit.



- Brexit has initiated or amplified developments. Good for the market. Good for your business.
- And yet it would be prudent for us to stay on the alert. Otherwise the quality, integrity and robustness of the capital markets will suffer.
- Today, I've gone through some of these aspects with you:
  - The importance of responsible trading in crypto derivatives and the way in which we should be developing DLT;
  - The challenge vis-à-vis the remuneration guidelines and the way in which this is impacting the integrity of the capital markets;
  - And the quest for the representation of fair prices by means of the consolidated tape.
- Let me be clear: we won't get there just by highlighting these points for attention.
- Genuine success won't be achieved by having a sensible regulatory body, of course – it goes without saying that we're doing our level best. It'll come by having sensible market players.
- And sensible means:
  - Thinking not only of your own interest in the short run but of the interests of the wider financial sector as a healthy ecosystem.
  - And also thinking of the consumer, where applicable. Specialists like you will always be better informed than a relatively uninformed consumer.
- Otherwise, there's a chance that our capital markets will lose their sheen. That we'll taking two steps back rather than one step forwards.
- And that's the last thing you and I want.
- Thank you for your time. Have a nice evening.