AFM view on FinTech for Parliamentary Finance Committee Round-table Discussion on 21 Jan. 2016

Driven by technology, the financial markets have been undergoing significant changes for some time already

As a result of technological advances and the large-scale acceptance of the Internet and mobile telephony, the financial markets are changing radically. This is true of the capital markets, where market making and placing large orders with the aid of algorithms has become standard practice. It is also true of consumer markets, where straightforward financial products such as non-life insurance, payment services and savings products are no longer obtained via bank branches or insurance brokers, but mainly via electronic channels. Players in the sector have adapted and are still adapting to the situation, which is having a major impact. For investors and consumers, the costs of securities trading and financial services have decreased significantly, there is a much broader – and more international – range of products available, and the range itself has become more transparent. As for market parties, they have had to adapt to a new reality, with established financial service providers like banks, insurers and advisers often still in the middle of that process.

Developments have recently gained momentum

However, the pace of development keeps accelerating. As a result of the availability of increasing amounts of data, in combination with technologies for converting this data into usable information (artificial intelligence), complex functions are increasingly being computerised as well. This applies to investment analyses and advice, estimating credit and damage risks, and the sale and distribution of financial products. Moreover, increasingly advanced identification, authentication and encryption methods allow the bypassing of links in the chain that, for now at least, are essential to ensure sufficient trust to maintain a healthy market. The change in market structure is being driven from both sides: the supply side (by fintech users) and the demand side (by consumers and investors). Technology will also boost the further internationalisation of retail markets.

Making chains more efficient through cutting out intermediaries and computerising processes that used to be manual creates opportunities for new players, and opens up possibilities for new types of earning models. Virtually all activities in the financial markets can only be computerised in an economically profitable way if they are conducted on a large scale. And we know, too, that the player who achieves the largest scale gains an enormous competitive advantage. However, these players need not be big enterprises. It could also be a matter of small niches in which small players capture dominant positions.

To illustrate the point, globally in 2015 around EUR 20 billion was earned by tech start-ups who were trying to innovate the financial world. This is an increase of 70% on 2014, and six times the amount three years ago. In the Netherlands, the fintech sector is growing steadily, and, following the example of other countries, a climate is developing where banks and fintech companies are starting to collaborate.

These developments raise new interpretation issues for the AFM

The transition in the market is giving rise to new supervisory questions for the AFM, as well as for the market itself. For example, how do we interpret the principle of "duty of care" in relation to a self-learning IT system that provides advice based on data from a variety of sources? How should market players treat customer data so that customer confidence is not dented, and what are the limits of the AFM's role in this? What grounds do we think justify differences in the prices consumers are asked to pay, and when do we consider that lack of knowledge or a weaker position is being abused?

We see our primary role as ensuring clarity regarding issues that follow in the wake of the fintech developments. We want to go along with the technological innovations that contribute to sustainable financial prosperity. At the same time, we intend to address the risks related to these innovations, and - within our remit - mitigate them.

These developments probably also require a revised approach to supervision

We also see that the technological developments are putting pressure on the way we carry out much of the supervision. A substantial degree of our supervision is still exercised by influencing large established players, who in turn influence the market as a whole because of their dominant position. With the change in market structure and the reduction in the control that large institutions have, this model will cease to work.

Another point is that it is undesirable as regards innovations beneficial to customers that new market entrants are immediately faced with an unnecessarily high obstacle in the form of regulations and costs. It is in the interests of healthy competition that such obstacles are as low as possible for new market entrants. A challenge here is increasingly to set a fair division of the costs of supervision.

And finally, the introduction of one or more *Big Tech* players from outside the sector, such as Google, Apple or Facebook, could potentially create major dilemmas for supervision within Europe.

Because of this impact, the AFM is investing in an Innovation & Fintech programme

The AFM is keeping abreast of these developments, with the intention of understanding their implications for the capital and retail markets. Innovations that serve the interests of customers will receive further support from us. Likewise for making a constructive contribution to the implementation of new regulations for these concepts and players. To help galvanise the organisation into action, we set up an Innovation & Fintech team within the AFM on 1 January.