Supervisory Strategy
2018-2022
3 focus areas for DNB’s supervisory strategy

1. Responding to technological innovation
2. Fostering a forward-looking and sustainable sector
3. Taking a hard stance on financial and economic crime

Trends & risks

- Economic and political uncertainties
- Sustainable economy
- Society & trust
- New regulation
- Technological developments

FINANCIAL INSTITUTIONS
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Foreword

The Dutch financial sector seems to have fully emerged from the financial crisis. However, it still faces various technological, economic and societal challenges.

These challenges are fundamental for financial institutions, and therefore also have direct consequences for the supervision of these institutions. In this new Supervisory Strategy for 2018-2022, we have therefore established the following three focus areas:

1. Responding to technological innovation
2. Fostering a forward-looking and sustainable sector
3. Taking a hard stance against financial and economic crime

We will focus more on these areas in the coming years, in addition to our regular supervisory activities. These focus areas are formulated for the financial sector as a whole, as the underlying societal trends and economic challenges do not apply to just one, but to all parts of the sector.

The common theme is continuous change. This applies to both the sector and to us as the supervisory authority. We must be both alert and agile in order to adequately respond to change. Effective supervision is after all not a static process, but a matter of continually striving for improvement and responding to new challenges. This vision therefore builds on the strategic course followed during previous periods.

The purpose of this new Supervisory Strategy is to inform the sector and other stakeholders about the approach they can expect us to take in the coming four years. Every year we elaborate these focus areas into specific supervisory themes, which we describe in our Supervision Outlook.

While developing this strategy we discussed the most important trends and risks for the financial sector with several parties, from umbrella organisations to NGOs, academics and international peer supervisory authorities. We would like to thank all our discussion partners for their insights and the valuable contribution to our new Supervisory Strategy 2018-2022.

Jan Sijbrand
Chair for Prudential Supervision and Governing Board Member

Frank Elderson
Governing Board Member
Effective supervision is not a static process, but involves continually striving for improvement and responding to new challenges

Jan Sijbrand
Chair for Prudential Supervision and Governing Board Member
‘We must be both alert and flexible in order to adequately respond to change.’

Frank Elderson
Governing Board Member
Introduction

Over the past decade, the financial sector has undergone a necessary transition to increase its financial resilience. It was necessary because of the causes and consequences of the most serious financial crisis since the Great Depression of the 1930s.

Banks have strengthened their capital buffers and have become less complex by divesting their insurance arms and reducing international activities. At the same time banking supervision has shifted from national to European level. Insurers are reducing their dependence on the shrinking life insurance market and are working to lower costs. They are now subject to a new risk-weighted supervisory framework, Solvency II. Pension funds have become more professional, with greater transparency towards members about meeting pension commitments.

Continuous change
This transition is however not finished. Quite the contrary; the new reality seems to be one of continuous change. Nowadays, financial institutions operate in a highly challenging environment. They face new technologically-advanced market players that offer improved levels of service. While the sector adapts at an increasingly rapid pace to the opportunities of technological innovation, in an attempt to keep up with competition from emerging FinTech companies, their business models are also under pressure from a prolonged period of low interest rates. Not only have European deposit rates been negative since 2014, ten-year capital market rates have also hovered around historically low levels, which has had consequences for banks’ profitability and investment funds’ liquidity sensitivity.

However, the playing field in the financial sector is not only changing as a result of technological and economic developments. Geopolitical developments also play a role. The impending departure of the United Kingdom from the European Union will have an impact, due for example to uncertainty over future trade relations and reciprocal access to the financial services market. At the same time, countries such as France and Germany want to build a stronger Europe, which could accelerate the trend towards European supervisory convergence. We go into further detail about our desired perspective for European supervision in the box, “Contours for European Supervision”.

Regulatory changes
In terms of legislation, upcoming national proposals and international guidelines are set to redefine the boundaries of the playing field for the sector. For example, the Second Payment Services Directive (PSD2) will cause a shake-up in the banking and payments industry. Furthermore, the legislative proposal for the recovery and resolution of insurers would alter the supervisory framework for the insurance industry, while the possible introduction of a new pension contract could potentially have far-reaching...
consequences for this industry. Changing consumer behaviour is also having an impact on financial institutions. Consumers are becoming increasingly critical, and are tending to vote with their feet more. There is a desire among consumers to know where their money is being invested, and if it is being invested sustainably. Our survey for example reveals that 68% of Dutch households consider it important for institutions to invest their savings and pension contributions in a way that contributes to a sustainable society.

Financial consumers are also becoming increasingly empowered, putting up an effective organised response to products or services that fail to meet their standards. They also expect financial institutions to behave ethically, and have no involvement in financial and economic crime.

### Taking a forward-looking approach

Following the introduction of new rules and regulations in response to the crisis, regulatory fatigue is now creeping into the sector, also due to the upswing in the economy. Although it is good to observe the effects of the many post-crisis regulations, and where possible to improve, simplify or scrap them, the dynamics of the situation we have outlined calls for vigilance from financial regulators and supervisors. Particularly in times of economic expansion, intensive and strict supervision is required to guard against the build-up of excesses. The financial crisis was preceded by a long period of deregulation. One of the lessons from the last crisis is therefore to take a forward-looking approach. The challenge is to prevent future crises, rather than to cure them, without placing unrealistic expectations on the supervisory authority.

### Responding to emerging risks

Our prudential supervision work essentially concentrates on institutions’ solvency and liquidity. Banks, insurers, pension funds and other institutions must have sufficient capital and immediately available funds to absorb shocks or downturns and to meet their obligations. We not only test whether institutions maintain the required amount of capital and liquid assets to overcome possible difficulties; we also want to know if they adequately assess the risks affecting their financial solidity. The financial crisis showed that failure to adequately manage risks can ultimately put pressure on solvency or liquidity. This prompted us to take a more forward-looking approach in our supervision. We therefore also examine whether financial institutions have the risk control processes, organisation, and management in place to ensure they have adequate oversight of current and future challenges and threats.

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1 In April 2017 we conducted a survey among a representative sample of Dutch households. Projects to tackle climate change and social inequality were named as specific examples of investing in a sustainable society.
Focus areas are interrelated
In view of the changes and economic, technological and societal challenges described above, we have established three focus areas to concentrate on in the coming years, in addition to and where possible within the course of our regular supervisory activities: 1) responding to technological innovation, 2) fostering a forward-looking and sustainable sector 3) taking a hard stance against financial and economic crime.

These focus areas are not mutually exclusive, but closely interrelated. For example, technological innovation plays a growing role in financial and economic crime, in terms of both how it is committed (internet criminals) and detected (transaction monitoring).

There is also a relationship between technological innovation and being forward-looking, as new FinTech firms can put the traditional business models of institutions under pressure, which therefore requires a forward looking approach in the longer term. Sustainability is also given added impetus under the wider approach of forward-looking, as sustainability risks (such as climate risks), can ultimately pose new prudential risks for banks, insurers, pension funds and other institutions.

Together, these three focus areas underline how we as the supervisory authority intend to stay ahead of the curve, in order to ensure solid and ethical institutions that meet their obligations and commitments, and contribute to a stable financial system and sustainable prosperity. We further elaborate on these focus areas in the following sections.
We consider openness a key component of effective supervision. We embarked on this approach in our earlier strategies, and it has evolved with the requirements of the time. For example, in the coming years we will strengthen our efforts to inform institutions how we formulate requirements such as for capital or liquidity. In our annual Supervision Outlook we also inform institutions of our goals, and what funds we will earmark from our budget to achieve them. We also discuss this with financial institutions. This dialogue – and our periodic stakeholder survey – lead to improvement and increased efficiency in the supervisory process. We will shortly set up a work group together with sector representatives to gain better insight into indirect supervision costs. We also provide the public and the government with an insight into the results of our supervision. By being clear about our aims, our resources, and by accounting for the results achieved, we can provide the public with an understanding of how we function.

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2 The Ministry of Finance indicates that since 2010, DNB has provided greater insight into the findings and result of supervision, as well as the supervision itself (needs and necessity, guarantees, choices). See also the five yearly report from the Minister of Finance assessing the efficiency and effectiveness of how DNB functions as an independent public body (2017).

3 See also the response of DNB’s Governing Board to the Court of Audit’s report on the Supervision of banks in the Netherlands, dated 5 September 2017.
Responding to technological innovation
1.1 Background

Technological innovation is taking off in the financial sector. There is exponential growth of innovative applications thanks to the wider availability of data and new technologies such as machine learning and distributed ledger technology.

With technological possibilities rapidly growing, customers are also quick to embrace innovative digital services. In the last five years for example, the number of mobile payments has grown tenfold, half of households use peer-to-peer platforms, over half of meetings to arrange mortgages are conducted via the webcam, and robo advisers and automated insurance claim processing are becoming more accepted.

Accelerated pace of digitization

Digital transformation therefore seems to be more of a necessity than a choice, and changes the nature of what institutions do. It is with good reason that banks and insurers refer to themselves more and more as "technology or IT companies", where data is a distinctive natural resource for the organisation. This has led to rapidly changing business models and organisational structures in the financial sector. However, this does not apply equally to all institutions. For example, the impact of technological innovation on the pensions sector has been much less pronounced to date. This could however change in the light of pension fund members' increasing desire to have greater control over their personal pension plans.

In addition to opportunities, these developments also introduce new (operational) risks and supervisory issues. These include for example questions on the approach of cloud computing within the financial sector, questions on how to deal with fragmentation in the chain of financial services and questions on the desirability of real-time supervision.

Three scenarios

In this section we explain how we address the issue of technological innovation in the financial sector, and how this is reflected in our supervision. Various future scenarios about the application of technology and its consequences are possible in this respect:

1) Established market players incorporate FinTech innovations in their own business models and operations.
2) New market entrants occupy an independent position, creating an ecosystem with a role for both the existing and the new market players.
3) Tech companies such as Apple, Amazon, Facebook and Google take over customer relationships, putting pressure on established players which end up in a facilitating and infrastructural role with a lower earnings potential.

It is not up to us to predict what the future situation will look like, but we do want to stress the importance of adaptability in all scenarios possible. This applies to both the institutions under our supervision and ourselves.

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4 See also the DNB report: Technological innovation and the Dutch financial sector, January 2016.
We want to anticipate developments inside and outside the sector and ensure we respond with the right supervisory actions.
‘It’s very good to see that DNB recognises the opportunities and risks of disruption, and has outlined them in this strategy.

I understand the dilemma that DNB faces as a supervisory authority. You want to give new innovations the chance to flourish in the financial world to keep the playing field competitive. At the same time, you want to avoid an uneven playing field which could arise if stimulating innovation leads to the emergence of bigtechs operating partly outside your control.’

Annet Aris
Adjunct Professor of Strategy at business school Insead and member of supervisory boards
We wish to allow room for the opportunities that technological innovation offers, to ensure a diverse and competitive financial sector with an improved level of service. We thereby seek a balance between facilitating these technological innovations for existing and new institutions, and at the same time mitigating the risks that arise. In cooperation with the AFM, we have set up the InnovationHub to answer questions about supervision. We also offer a ‘Regulatory sandbox’ when existing financial laws and regulations are unnecessary bottlenecks. In light of new technological developments, we concentrate primarily on the purpose of laws and regulations to allow room for innovation without increasing the risks. Over the coming years, the capacity of our InnovationHub and Regulatory sandbox will grow in line with market developments. Based on this approach and the development of our policy in this area, we aim to become an international frontrunner in the area of supervision and FinTech.

Data driven supervision
In our own supervision we aim to make better use of new technologies and to use increasingly more granular data. Supervisors work to a growing extent on a data-driven basis, not only to detect risk effectively, but also for preliminary selections and technologies. This will enable us to further strengthen our risk-based supervision, and to allocate our supervisory capacity to those areas with the highest risks.

Experimenting to learn
We will also study the range of applications for new technologies and data sources. For example, in an experimental environment we have started studying the possibilities of natural language processing to analyse pension funds’ reports. Another experiment focuses on detecting networks by applying algorithms to large data files of money transfer offices. We would like to further develop such experiments. In this respect, we call on third parties to share their ideas on how we can use such technologies for the supervision process. If the experiment proves successful we will scale it up and incorporate it into our supervisory methodology.

Improve data quality
Data-driven supervision also requires us to focus more strongly on the quality of the data that institutions provide. The development of regulatory technology can help institutions to structure their reports more efficiently. In the case of such RegTech applications, we will monitor whether institutions take up and maintain their responsibilities in terms of reporting requirements. While continuing to strictly monitor the quality of the data that institutions provide, we will also further digitise our own supervisory processes and...
communications with institutions. In the coming years there will be increasingly more communication through digital channels, such as the Digital Supervision Portal (DLT) for authorisation and fit and proper applications, and the Digital Reporting Portal (DLR) for reporting. There will also be more possibilities for increasing the frequency of the data supplied. For example, we are currently exploring opportunities with the sector for conducting supervision in real time. In this respect we plan to develop a vision about the desirability and legal consequences of real time supervision.

Enhance knowledge
Responding to technological innovation requires an investment in human and financial resources. In order to assess new risks, specific knowledge in the areas of technology, cyber risk and data science is required. We invest in lifelong learning for all our staff by developing training programmes, and we also make use of knowledge from the industry in particular. We focus on knowledge-sharing and cooperation in order to obtain maximum added value from technological innovation in supervision. We will also invest in ICT infrastructure due to increased processing, accessibility and use of structured and unstructured data.
'The rapid pace of technological developments is high on the supervisory agenda. Sweeping digitization of financial services has brought new entrants and business models to an increasingly international playing field. The AFM, DNB and other European supervisory authorities are cooperating increasingly closely in this area.'

Merel van Vroonhoven
Chairman of the Executive Board of the Dutch Authority for the Financial Markets (AFM)
1.3 Risks

As the supervisory authority, we must be prepared for a future financial landscape shaped by different scenarios, and to move quickly to address any disruption. Irrespective of what the future brings, in all scenarios we will continue to foster stable financial services and financial solidity. That not only means institutions must have sufficient financial resources to meet their commitments to savers, policyholders and pension fund members, but also to ensure that their processes are sufficiently robust. It is expected that the operational stability of institutions and their service providers will call for closer supervisory attention as a result of technological developments. Technological innovation in the first place results in changes to operational processes. We therefore want to obtain a greater insight into institutions’ control measures regarding business continuity, and a sharper focus on the shifts in power and concentration in payment and services chains.

New supervisory questions
We are aware that the increased and automated use of data presents potential vulnerabilities. For example, the emergence of robo finance, robo advisers and robo audit also poses new supervisory questions about the use of algorithms and personal data. We study the use of data and (self-learning) algorithms at institutions, the quality of the data used, and how the management and supervision of this (data governance), is set up at institutions, including the extent to which the required specialised expertise is present in the organisation. This is important for institutions’ operational management and duty of care. In the field of automated data we expect to step up cooperation in this area with the Dutch Data Protection Authority (AP) and the Netherlands Authority for the Financial Markets (AFM).

Standards for outsourcing
We will focus particularly on the risks associated with IT outsourcing, such as cloud computing. Our supervisors must have sufficient insight into the measures financial institutions take to control these risks. In the coming years we want to apply uniform criteria to assess IT outsourcing and cloud applications, based on the principle that institutions must actively manage the entire chain of outsourcing relationships.

Institutions are increasingly vulnerable to cybercrime due to growing digitization and the mutual dependence between systems, in combination with the increasingly advanced nature of cyberattacks. We therefore devote ongoing attention to information security management in the sector, including assessing the maturity of organisations’ cybersecurity setup. We take a targeted approach in this respect,

\[5\] In our supervision of this area we utilise the synergies generated on oversight of the payment and securities systems. Here, we impose requirements on institutions, systems and products that are relevant to payments in the Netherlands.
focused for example on institutions' cybersecurity centres. Another method we use to test the effectiveness of a security system is to simulate a cyberattack through red team testing. We use the results to add to our knowledge and to make systems more resilient.
Fostering a forward-looking and sustainable sector
2.1 Background

We expect banks, insurers, pension funds and all other institutions under our supervision to be able to adapt in a controlled manner to changing circumstances, so they can remain financially sound and meet their commitments to customers.

An institution’s solvency and liquidity are key in this respect. Banks, insurers, pension funds and other institutions must have sufficient capital to absorb shocks, and enough liquidity to meet short-term obligations. In assessing risk for capital and liquidity buffers, we expect institutions to anticipate changes that will affect their business operations. As the financial sector will enter a dynamically changing environment over the coming years, a forward-looking approach is vital. The environment is subject to not only changes caused by technological innovation (Section 2), but also in the area of supervisory regulation and economic uncertainty, including the interest rate climate.

**Low yield environment**

The current low interest rate environment has a major impact on all areas of the financial industry. Dutch 10-year capital market rates have already been below 1% for four years. For financial institutions it is uncertain how long interest rates will remain this low, but both spikes and persistently low capital market rates affect their financial positions. Banks’ profitability is vulnerable to this, and for pension funds and insurers, interest rates have a direct impact on funding ratios and solvency.

**Regulatory changes**

As well as interest rates, new legislation and regulations also require the sector to adapt. The arrival of a new pension contract, with more room for individual pension accrual, will have a major impact on the sector. Examples of other far-reaching changes include the risk weighting for credit risk under the Basel 3 framework (also referred to as Basel 3.5), the new European Payment Services Directive (PSD2), the new IFRS9 accounting standards, and the new European Privacy Directive.

Interest rate developments and new legislation are just two examples of rapidly changing circumstances that affect an institution’s solvency, liquidity and adaptability. In the last section we already referred to technological innovation as a driving force behind changes. We encourage institutions to adapt in good time to the new challenges, regardless of their nature. We therefore foster a sector that is forward-looking, and in particular, sustainable. By emphasising a forward-looking and sustainable sector, we build on the approach we embarked on after the crisis. Heightened attention

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6 The requirements and rules in this regard are established in various supervisory frameworks. The most important supervisory frameworks are the European Capital Requirements Regulation and Capital Requirements Directive (CRR and CRD IV) for banks and investment firms, Solvency II regulation for insurers and the Financial Assessment Framework for pension funds.
to behaviour and culture, and the sustainability of business models are a clear outcome of our earlier efforts, and have since become a permanent feature of our supervisory approach.

“Through-the-cycle”-horizon
In addressing this focus area, we have chosen an approach that explicitly extends beyond the short-term outlook. We foster a forward-looking approach in institutions, based on a “through-the-cycle” horizon. We will also devote more attention to sustainability. This includes the impact of climate risks and policy and the effect of other relevant sustainability risks on the financial sector. These are longer-term risks, but can also already have an impact in the medium term, and they therefore require our immediate attention.

The activities we have planned are described in the following paragraphs.
‘As an industry we must anticipate the needs of our future customers, and be able to innovate swiftly.

In this respect we must make sure we safeguard security and privacy. That means seizing opportunities and upholding values. It’s also important that the supervisory authority keeps this in mind.’

Chris Buijink
Chairman of the Dutch Banking Association
2.2 Forward-looking sector

We strive to ensure that the financial sector is flexible and adaptable in thought and in action. Institutions must demonstrate they have a clear and forward-looking strategy. In this respect it is also important that the sector is prepared for a range of scenarios, in view of the heightened unpredictability in the financial system and its environment. To achieve this, we will take action in the following five areas:

**Risk assessment process**

Firstly, there must be a solid basis. This essentially relates to the solvency and liquidity of banks, insurers, pension funds and other institutions. In our supervision we check whether the institution itself accurately estimates the risks it faces, both financial and non-financial, and maintains sufficient capital and liquidity to mitigate these risks. We test the quality of the available capital, and assess whether it can in fact serve as a buffer that can be drawn down, and if the measured liquidity is also actually readily available. We also test whether the risk assessment process has been adequately set up, and is correctly reflected in capital and liquidity buffers.

Secondly, we will systematically scan the resilience of business models through on-site inspections and scenario analyses. Supervisors must be convinced that the institutions under their supervision are adequately prepared for expected developments, and are able to pro-actively respond to unexpected developments. This applies for example to the implementation of new legislation and regulations, such as the new IFRS9 accounting standards. We assess whether the institution has strategic oversight of the consequences, and is able to manage this at an organisational level.

**Adaptability**

A third area for attention is adaptability. In addition to a clear strategy, financial institutions also need to be sufficiently adaptable to respond to the developments they face. We also verify whether institutions can demonstrate that they are actually able to implement their strategic decisions. This particularly applies to institutions on the threshold of important changes such as reorganisations, the launch of new products, penetrating new markets or outsourcing processes. We will assess whether institutions are able to successfully implement such changes.

Fourthly, we want to prepare institutions better for crisis situations, with resolution as an ultimate solution.
if recovery is no longer possible. Over
the coming years we will develop
instruments with which to put failing
institutions into resolution. In the
banking sector, we have already taken
important steps as part of the Single
Resolution Mechanism. The resolution
function is still less developed in the
insurance sector. This will require
additional efforts, with proposed
legislation and regulations in this area
laying down an important framework.

**Scope of supervision**
Lastly, the above actions also require
us to devote sufficient attention to the
adaptability of our own organisation.
In this respect, questions on the scope
and focus of our supervision should be
addressed in greater depth. The financial
landscape is becoming fragmented,
partly due to the growth of FinTech
and more outsourcing of key ICT
functions and applications to non-
financial parties. This gives us cause to
consider our approach for supervising
new players that could be relevant for
financial stability, such as supervising
specific activities instead of just
supervision of the institutions. During
the next few years we will address these
and other issues, and discuss them with
our stakeholders.

**Proportionality**
The multitude of post-crisis rules have
also prompted a demand for supervision
that is more proportionally structured.
Proportionality does not mean less
stringent rules but an approach that is
more tailored to the specific risks an
institution faces. Smaller institutions
do not face risks any less than the large
institutions do; the risks are above all
different in nature. Smaller institutions
face risks that are often concentrated
on a specific activity, while they have
few possibilities for lowering their risk
profile by diversifying their activities.
2.3 Sustainability

By integrating sustainability in our supervision we also foster a forward-looking approach within the financial sector. The 2015 UN Sustainable Development Goals (SDGs) provide a conceptual framework for guiding sustainable development. The SDGs set out targets to be achieved by 2030 in 17 different areas such as climate action, sustainable cities and communities, infrastructure and responsible energy production.

Towards a carbon-neutral economy
Several SDGs affect activities in one or more areas of the financial sector. Non-life insurers are for example likely to experience a rise in claims as a result of changing weather patterns. The transition to a carbon-neutral economy that has now been set in motion is also likely to affect the financial sector. Climate policy measures and rapidly advancing carbon-neutral technology trends could lead to write-downs of loans and investments in companies with carbon-intensive production processes. Financial institutions must focus more on these risks. For example, increasingly tightened sustainability requirements can present specific challenges to the Dutch office market, with consequences for providers of finance.

Understanding sustainability risks
We want to contribute to embedding sustainability in supervision in the Netherlands and also at international level. There is an increasing international focus on sustainability reflected in, for example, the EU High-Level Expert Group on Sustainable Finance, in which we are active participants. We have also for some time facilitated developing and sharing knowledge about increasing sustainability in the sector through the national Sustainable Finance Platform.

In our supervision we strive to ensure that the financial sector understands the risks related to sustainability and where necessary mitigates them. Our approach here comprises four action areas.

We will firstly analyse the magnitude of potential sustainability risks, and how they translate into prudential risks. In addition to the SDGs mentioned above, this also concerns the transition to a circular economy. We will report on these analyses and make use of impact assessments and stress tests to indicate where a critical limit is reached, taking a risk-based approach.

8 In its proposal to the European supervisory authorities of April 2017, the European Commission called for financial supervision to have a greater focus on sustainability. The European Supervisory Authorities (ESAs) include the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).
Secondly, for our peer supervisors and in international fora we want to be a thought leader in addressing sustainability issues in financial supervision. We will therefore also further embed sustainability in our (international) policymaking, and put it on the agenda where necessary. In formulating new policy, we will take the impact of the SDGs into account.

Thirdly, we will identify whether there are any barriers obstructing financial institutions from pursuing a sustainable approach, following on from our examination in this area for pension funds. If this is the case we will study the possibilities for removing these barriers. In this respect, it should be noted that prudential legislation and regulations are not in principle intended to stimulate sustainable financing. Prudential regulations are primarily intended to ensure the solidity of financial institutions.

Finally, we will examine how sustainability risks can be included on a more systematic basis in the supervisory process. As part of this, we will more explicitly include these risks in training programmes for supervisors.
'As soon as financial firms see reporting and monitoring on sustainability as an issue, they start investing in it, measuring it, understanding it, and modelling it. It has a deep impact on the strategies of corporations.'

Christian Thimann
voorzitter High Level Group of Sustainable Finance
en hoofd strategie, duurzaamheid en public affairs bij AXA
Banking sector - Since November 2014 prudential supervision of Dutch banks has been conducted at European level. Under the Single Supervisory Mechanism the ECB works together with DNB and other national banks on common banking supervision. The SSM has contributed to the convergence and consistency of a common supervisory approach. This benefits the stability of the European banking sector and strengthens the single market for banking services. In this context we will continue to conduct intensive and strict supervision. We are committed to ensuring our supervision also takes into account the various risks of specific banking models, and that the associated capital and liquidity requirements are proportional to these risks. We also see room for improvement in the banking union through effectively applying the European Bank Recovery and Resolution Directive. It would also be helpful to introduce measures to limit the amount of government paper on bank balance sheets. Lastly, we support introducing a European Deposit Guarantee Scheme as the third pillar of the Banking Union.

Insurance sector - In the context of supervisory convergence, we support a greater role for the European Insurance and Occupational Pensions Authority (EIOPA). We are also committed to further harmonisation of European insurance regulations, including in the area of recovery and resolution. In addition, we will continue to work on developing a more realistic method to determine the ultimate forward rate (UFR), the calculation method for long-term liabilities. Furthermore, we will continue to foster capital requirements that reflect insurers’ risk profile and are consistently applied. However, we do not see grounds for setting up a European insurance union, as the insurance sectors in Member States are very different in nature and size, and their systemic relevance is generally smaller and their interdependency with governments is lower than with banks.

Pensions sector - We expect only very limited harmonisation in terms of supervision, as pension systems are usually closely connected to domestic labour legislation and tax systems, and as a result differ
considerably from each other. We do however advocate more convergence in the area of pension supervision. For example, we initiate and support initiatives relating to benchmarking or common frameworks for setting up governance structures for pension funds, and communication to members. We also support the European stress test for pension funds.

**Payment institutions** - We call for the consistent application of (European) standards and supervision to payment services activities. This call has become more urgent due to the introduction of the revised Payment Services Directive (PSD2), which allows payment institutions and banks to offer innovative payment services across national borders.

**Investment firms** - The prudential supervision of investment firms is organised at national level. We call for supervision of systemically relevant investment banks to be brought under the SSM. Due to their size and the cross-border nature of their activities they can after all have a major impact on financial stability. This will become a matter of urgency if UK investment firms relocate to the continent in the event of a hard Brexit.
Taking a hard stance against financial and economic crime
3.1 Background

Financial and economic crime comes in many forms, such as money laundering, corruption, terrorist financing, insider trading and non-compliance with sanctions regulations. Combating these crimes is one of our key priorities, as they can harm confidence in the financial system. As “gatekeepers” to the financial system, financial institutions play a crucial role in detecting and preventing criminal money flows.

At international level too, financial and economic crime is high on the agenda, and e.g. the EU and the US are intensifying their efforts by continuously developing and implementing legislation and enforcement measures. Since 2009, the fifty largest US and European banks together have been fined over USD 320 billion for involvement in money laundering, violation of sanctions regulations, benchmark manipulation and misrepresentation. This amount illustrates that the financial sector is and remains vulnerable to financial and economic crime. Furthermore, regulators and supervisory authorities impose measures upon financial institutions in order to get them to effectively prevent involvement in financial crime.

Public outcry

Despite all these measures, we observe that Dutch financial institutions are still insufficiently aware of their role as gatekeepers to the financial system. Their response to the risks they are exposed to is inadequate, and we often encounter resistance in our efforts to address this issue. However, a summary interpretation and mechanical application of statutory requirements aimed at ethical operational management and combating financial and economic crime is undesirable. Moreover, this kind of behaviour could conflict with the legal requirement of social propriety.9 A recent example includes the involvement by financial institutions in their customers’ aggressive tax structures, which led to growing public outcry (e.g. the Panama and Paradise Papers). To encourage the sector to step up and fulfil its gatekeeping role, we will more emphatically address this subject in our supervision.

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9 By law, financial institutions are obliged to prevent acts from being committed which conflict with commonly accepted social practices to such an extent that they may seriously damage confidence in the institution or in the financial markets. See Section 3:10(1) of the Financial Supervision Act (Wet op het financieel toezicht – Wft). The concept of social propriety also plays an important role in the upcoming 2018 Act on the Supervision of Trust Offices.
‘Major financial and economic crime, such as serious cases of corruption, is not possible without the involvement of financial institutions and professional service providers. The gatekeeper role these institutions must play is therefore essential in preventing such crimes. We should be much quicker to ask questions about who we do business with and why – it is allowed, but does it fit in with what we do? – This demands a great deal from departments such as Ethics & Compliance, Legal and Audit, but also from the people in charge, the board mainly. It’s unusual to see the rewards straight away, but that doesn’t mean they are any less important: a cleaner financial system and no potential disruptive scandals for the organisation.’

Arjen Tillema
board member of Transparency International Netherlands
3.2 Responsibility

Those institutions that do take appropriate measures to prevent financial and economic crime also demonstrate ownership of the gatekeeper role. They are aware of the risks they are exposed to and are prepared to identify, analyse and mitigate them using the three lines of defence model. This is why we encourage institutions and boards to take up responsibility and prevent themselves from becoming involved in financial and economic crime. However, supervisory practice shows that ownership is often limited to the compliance function, and to a lesser degree the audit function. Robust lines of defence with final responsibility at board level are essential to ensure first-line commitment. The first line primarily directs ethical operational management in the institution’s customer acceptance, service provision, product development and investment decision-making processes. The second and third lines have a counterbalancing function. We aim to lead financial institutions, their directors and policymakers towards taking responsibility for preventing involvement in financial crime. We intend to work towards strengthening and professionalising the compliance and audit functions.

Use intervention powers

In the event of malpractices or deficiencies with respect to ethical operational management, we will use our statutory powers to intervene. If necessary, we will hold policymakers personally liable. If the deficiencies observed are of a criminal nature, we will consult with the Public Prosecution Service to discuss prosecution options, even if this concerns natural persons.

Using education and information, we will encourage institutions and board members to take up their responsibilities. We will use the forthcoming legal options at our disposal to be more transparent about sectoral results achieved and enforcement measures taken. We will share good practices by “naming and shaming” and publish our own supervisory frameworks and development models. We will continue to engage in dialogue with the sector in seminars, round tables and discussions, and publish the fines and penalties we impose.

10 The proposed Transparent Financial Market Supervision Act will give DNB and the AFM more options to disclose breaches by institutions and publish relevant figures. The proposal was submitted to the Dutch Lower House in September 2017.

11 These development models show an institution’s level of compliance with relevant requirements from the Wft and Wwft. The level of compliance is defined according to a four-point scale: (1) non-compliant to (4) best practice.
3.3 Methods

We endeavour to be at the international forefront in combating financial and economic crime. The Financial Action Task Force on Money Laundering (FATF) will be assessing our progress in 2020. In accordance with the guidelines of the European Banking Authority (EBA) and the FATF, we apply a risk-based approach in our supervision work. Using information and data-driven applications we want to be able to identify risks and vulnerabilities at an early stage, and detect and assess breaches. There is a clear relationship with the first focus area of this Supervisory Strategy and our ambitions in the field of data-driven supervision.

Analyzing transaction patterns

While we are now applying data-driven supervision on a limited scale, for example in our analyses of money transaction offices’ transactions to detect transaction patterns that could indicate money laundering or terrorist financing, we intend to apply this more broadly in the coming period. In addition, we will continue to focus on new developments such as e-discovery. We will develop financial and economic crime risk profiles for each institution and each sector, based on periodically requested and other available data. These risk profiles will to an important degree determine our supervisory priorities and intensity for the individual institutions and the sector as a whole.

Cryptocurrencies

We will closely monitor the developments concerning virtual currencies. The risks we are currently observing in this area already have our full attention. The investigative authorities are increasingly encountering the use of virtual currencies in money laundering and terrorist financing. As these currencies can be traded anonymously and are therefore harder to trace, they are very attractive to criminals. The European legislative body is alert to this phenomenon and is in the process of preparing relevant legislation. This may lead to regulation of custodian wallet providers i.e. the platforms for facilitating the conversion of cryptocurrencies into regular currencies.

We will promote further cooperation and priority-setting between the partners of the Financial Expertise Centre (FEC), including the Public Prosecution Service, the police, the Fiscal Intelligence and Investigation Service (FIOD), the Tax and Customs Administration, the Financial Intelligence Unit (FIU-NL) and the AFM. We will also promote joint risk identification and assessments using intelligence and data analyses. Where possible, we will share our insights with the sector, as these may help the sector to step up their efforts in effectively combating financial and economic crime.
Last but not least, we wish to promote interinstitutional cooperation. At international level, various joint initiatives are emerging, e.g. in the area of customer due diligence. Such initiatives help to more efficiently and effectively combat financial and economic crime more efficient and effective.
‘The position of financial institutions as gatekeepers to protect financial systems, the broader economy and to contribute to safety and security, has never been more important.

It is vital that financial institutions, including their directors and officers, take responsibility and hold each other accountable for robust and sound business operations, in order to prevent financial crime and to detect and stop the illegal flow of funds. At the same time, financial institutions and their supervisors must ensure that their actions promote greater inclusiveness and increase transparency of financial transactions.’

Santiago Otamendi
president Financial Action Taskforce
Box 3  Utilising synergies

DNB makes full use of the synergy stemming from its combined role of central bank, national supervisor and resolution authority. Efficient information and knowledge sharing, cooperation and internal staff rotation allow us to maximise the benefits of combining different public roles under the same roof. For example, the organisation as a whole benefits from the insights gained in payments supervision (oversight) with respect to cybercrime\(^\text{12}\) as well as from the distributed ledger technology experiments. In times of increasing capital market tensions in some euro area countries, our combined role of central bank and supervisor has provided us with enhanced insight at macro prudential and micro prudential level into the situation at systemic level, as well as at the level of individual institutions. While resolution is independent from supervision, close coordination, information and knowledge sharing between these two tasks help to strengthen our level of expertise in both areas. At international level, we create synergy benefits by linking knowledge from different expert areas in our policy work in order to gain a comprehensive overview, while international consultations are becoming increasingly fragmented.

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\(^{12}\) This is why, in tandem with other institutions in the financial core infrastructure, we have developed a framework for simulating sophisticated cyberattacks and testing resilience against these attacks (Threat Intelligence Based Ethical Red-teaming – TIBER).
A **custodian wallet provider** is an entity that provides services to safeguard private cryptographic keys on behalf of their customers, to holding, store and transfer virtual currencies. The service makes the usage of virtual currencies easier.

**Customer due diligence** is also referred to as “Know your customer” (KYC). It is the process of a business identifying and verifying the identity of its clients. The term is also used to refer to the bank and anti-money laundering regulations which govern these activities. The objectives of KYC guidelines are to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. Related procedures also enable banks to better understand their customers and their financial dealings. This helps them manage their risks prudently.

**Distributed ledger technology** such as blockchain removes the need for centralised verification and processing, which occurs on a decentralised basis through participants in a network.

**E-discovery** means searching large volumes of electronic data for a specific purpose.

**Fintech** involves the application of technological innovation in the financial sector.

**Machine learning** is a form of artificial intelligence aimed at developing algorithms and techniques that allow computers to learn, through for example recognising patterns based on repeated analysis of the latest data.

**Natural language processing** – also referred to as computer linguistics – makes use of artificial intelligence to analyse language. This allows for example texts to be automatically summarized or analysed for keywords.

**Red team testing** involves a simulated cyberattack carried out by ethical hackers using several attack scenarios. The aim of the exercise is to steal the organisation’s latest technology and “secrets” while escaping detection, and at the same time testing the organisation’s detection and response capacities.

**RegTech** (regulatory technology) is the term used for new techniques or software to provide regulatory reports or overviews.