Supervisory Strategy

2021 – 2024

DeNederlandscheBank

EUROSYSTEEM

Contents

Introduction

This updated Supervisory Strategy appears while the coronavirus crisis is spreading. Not only is the societal impact significant, the crisis also creates a great deal of uncertainty that is felt in almost all sectors of the economy. Like the ECB, we have partially released buffers in the short term, giving banks more room to support the real economy. We also called on banks not to pay dividends for the time being. By keeping as much capital available as possible, banks are in a better position to absorb losses. At the same time, the financial sector must be ready for other risks and uncertainties as well. For example, Brexit, for which the sector has made operational preparations, but whose economic impact is still uncertain.

Good supervision implies that we act alert and agile in the event of a crisis. During a crisis, a supervisor's activities are most visible to the outside world. We must be able to act decisively in such circumstances, often under great pressure of time. The foundation for timely and decisive action is laid in good times, by critically assessing institutions' risks and committing to appropriate control measures as part of our regular supervisory activities.

Both in good times and during a crisis, supervision helps to generate the trust that savers, insured persons and pensioners have in the financial sector. Good supervision sets clear priorities that contribute to an efficient deployment of resources. Available supervisory capacity is deployed there where risks are greatest. That is the guiding principle of risk-based supervision.

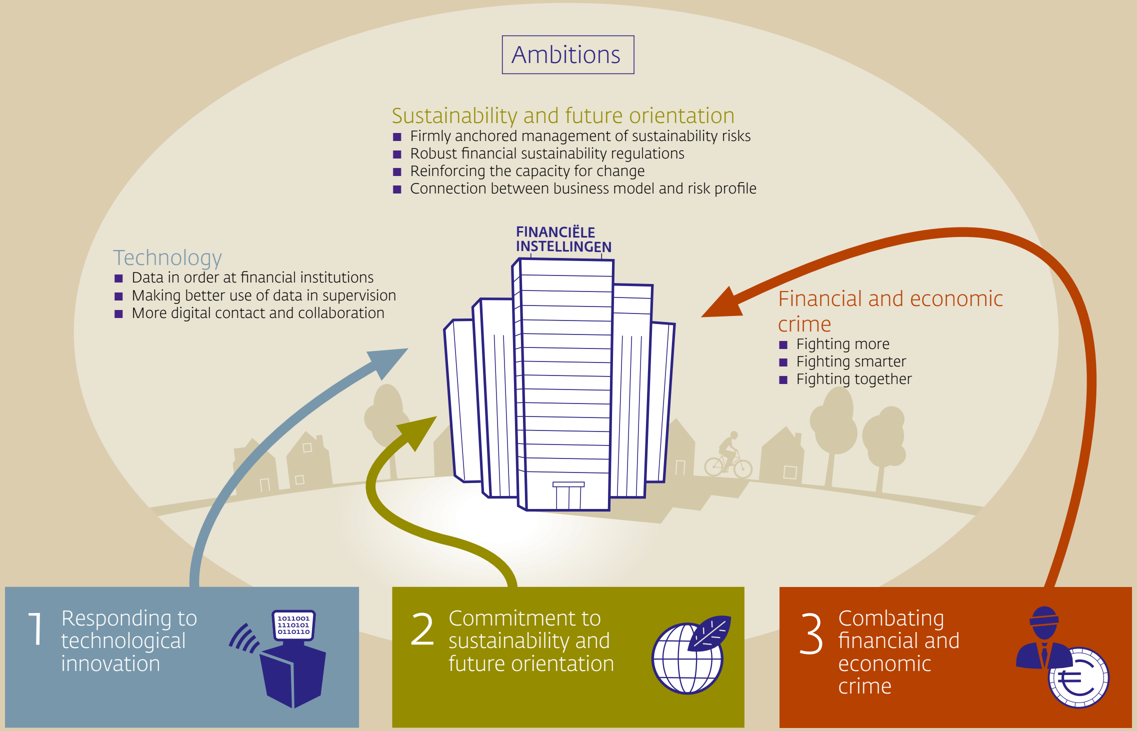
This Supervisory Strategy provides insight into DNB's risk-based supervisory approach and further elaborates the three focus areas of the preceding Strategy document[1]. Although the preceding document was issued only three years ago, our revised supervisory approach and a new, multi-annual supervisory cost framework prompted us to review our Supervisory Strategy. This updated version now covers the same period as the cost framework. In addition, we have further elaborated the focus areas described in the previous Supervisory Strategy. We have translated the three focus areas into ambitions, thereby specifying what we expect of institutions and what institutions can expect of us.

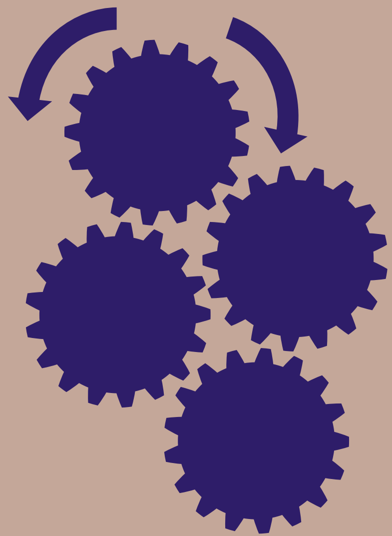
These focus areas complement our regular supervision. This updated Supervisory Strategy is in line with the principles of *DNB2025: Vision and Strategy*[2]. The next chapter provides an overview of long-term structural challenges for the sector. We then describe our risk-based supervisory approach. Last but not least, the three focus areas are further elaborated.

1 Supervisory Strategy 2018-2022
2 See DNB2025: Vision and Strategy

Three focus areas in brief

The three focus areas are: responding to technological innovation, commitment to sustainability and future orientation, and combating financial and economic crime.
In the coming years, our response to technological innovation will focus on: (i) increased use of data, which brings new opportunities and risks, (ii) intensification of data use in supervision and (Iii) digital communication with the sector. There are plenty of opportunities for sustainability and future orientation. In this regard, it is important that (i) the management of sustainability risks is anchored at institutions and (ii) robust international sustainability regulations are developed. (iii) Institutions must also be agile with regard to changing market conditions to protect their business models and (iv) take into account their risk profile in this. Combating financial and economic crime is aimed at eliminating illegal use of the financial system by means of (i) an intensified supervisory approach, (ii) the use of smarter methods, and (ii) a more international approach to financial and economic crime.





Structural challenges

Structural challenges for the sector

Financial institutions operate in an environment that will be changing considerably in the coming years. This is why we focus more emphatically on structural challenges whose impact is only gradually becoming apparent, but which call for responses by financial institutions at the strategic level. Firstly, new technology impacts business models. Secondly, the financial sector faces the challenge of financing the transition to a sustainable economy. Thirdly, persistently low interest rates undermine the resilience of institutions. Lastly, the sector will be facing new legislation and regulations.

Changing business models

The business models of financial institutions are changing. Products or services that were for a long time only being offered by a specific type of institution are now fully marketed by other parties. Examples would be pension funds and insurers, which have gained significant market share in the mortgage market in recent years, or payment institutions that are offering an increasing range of banking services. Meanwhile, financial institutions are increasingly outsourcing processes or parts of their services to third parties. For example, not only are back-office and IT processes performed by specialised external parties, customer contact is also increasingly conducted through other companies, such as digital platforms.

Financial institutions and technology companies are slowly converging. Technology and data play an increasingly crucial role for financial institutions[3]. Banks and insurers are closing offices, offering almost all of their services online. This has been given an additional boost during the coronavirus crisis, as consumers who were previously reluctant to manage business online are doing so now. At the same time, technology companies are expanding their financial services. In China, tech giants such as WeChat and Alipay handle almost all digital payments, while in Europe parties including PayPal, Google and Apple provide financial services. And while this is going on, the range of services offered by banks is increasingly converging on those provided by tech giants. Technology companies also provide financial IT systems at the back end. Financial institutions face the challenge of assessing and managing the risks of these shifts to their business models in a timely fashion.

The boundaries between supervised and non-supervised entities are beginning to blur, which sometimes necessitates extending the scope of supervision. An example would be crypto service providers, which are now required to register and are subject to DNB's integrity supervision.

Making the economy more sustainable

There are opportunities for the financial sector to finance the transition to a sustainable economy. Climate change and the energy transition are two major structural challenges for society. The EU has committed to a green recovery after the coronavirus crisis in the Green Deal. As a result, in the coming years both regulation and funding will be strongly focused on significant reductions in carbon emissions and achieving climate neutrality by 2050. Investment demands for the development of renewable energy and reduction of carbon emissions will require many billions of funding per year.

3 See also Transforming for trust. Lending, saving and paying in the data age, DNB, 2020.

At the same time, there is a need for adequate management of climate and environmental risks. Setting up proper climate and environmental risk management processes poses a challenge to financial institutions, as they must avoid addressing sustainability risks insufficiently or too late. Examples of sustainability risks include financial risks that may arise from financing fossil fuel extraction or from material damage caused by climate change.

Persistently low interest rates

Not only are interest rates lower than ever, these low interest rates may be sustained for a long time. In recent decades, interest rates have gradually fallen to historically low levels. Moreover, in view of the structural causes underlying this trend, interest rates may remain low for a long time. The coronavirus crisis's negative economic impact also contributes to this. Banks, insurers and pension funds each suffer from low interest rates in their own way.

Banks are more resilient if their business model is less dependent on interest income. Banks are facing both the consequences of a flat interest term structure and a negative policy interest rate. As banks do not yet fully pass on the negative ECB interest rate to private savers, their borrowing margin is eroding.

A DNB study[4] shows that interest margins will continue to decline if the current market interest rate level is maintained. Banks can increase the future-proofness of their business model by reducing their dependency on interest income.

The business model of life insurers is under great pressure given the persistently low interest rates. To ensure profitability, insurers need to sell new life insurance policies with relatively high premiums. Due to high premiums and tax adjustments, these products have become increasingly less attractive to customers and few life insurances have been taken out in recent years. In addition, the margins on existing policies will come under pressure if the interest rate risk was not fully covered in the past. Insurers' liabilities increase when interest rates decline, but Solvency II only shows the full impact of this with a delay. Some progress has been made in future-proofing the sector through cost-cutting, consolidation and product rationalisation, but it remains highly vulnerable to low interest rates. The challenge for insurers in the coming years will be to achieve sufficient returns to pay out the benefits they have promised.

The new pension system no longer commits to pension entitlements, thus shifting risks to the participants. In addition, the new pension system ensures that the risks to which younger and older participants are exposed are better suited to the risks they are prepared and able to bear. Because of this, the interest rate risk is shared between generations to a lesser degree. The Pension Accord is a crucial step towards a future-proof pension contract. However, it is not a panacea for persistently low interest rates. If interest rates stay low, pension accrual remains more expensive than in the past. Although the Pension Accord makes the agreements and expectations for the future pension more transparent and balanced, it does not offer a solution to the higher cost of pensions. After all, the value of pensions remain primarily dependent on contributions and returns. We therefore expect pension funds to remain financially sound and maintain their funding ratio. This may make taking more investment risk in order to achieve higher returns seem attractive, but this is accompanied by a greater likelihood of a lower pension. Taking more investment risk is therefore not a solution to the challenge of persistently low interest rates.

4 See Box 1 in Transforming for trust. Lending, saving and paying in the data age, DNB, 2020.

Changing laws and regulations

Institutions are faced with changing prudential legislation. For example, for pension funds the implementation of the Pension Accord is of central importance, while for banks the implementation of an adjusted capital framework – known as Basel 3.5 – is on the agenda. A key implication of Basel 3.5 is to limit the use of internal risk models. Due to the coronavirus crisis, buffer requirements for banks have been relaxed temporarily. On behalf of insurers, proposals will be made to adjust the Solvency II Directive. For investment firms, the introduction of the Investment Firm Directive (IFD) and the Investment Firm Regulation (IFR) leads to prudential requirements that are more risk-sensitive and proportionate. Solvency requirements will be based on indicators appropriate to the specific risks of investment firms, such as assets under management and advice.

The coming years, the European Commission (EC) will be launching legislation to increase digital resilience and to combat financial and economic crime more effectively. Among other things, the EC will be introducing the Digital Operational Resilience Act. This includes safeguards to ensure that information security is in order and that oversight on critical service providers, such as cloud service providers, is regulated. The EC is also working on a new anti-money laundering framework. This is aimed at creating a more level playing field among EU jurisdictions for supervision aimed at preventing financial and economic crime. Work is also under way on a European supervisory authority in this area. In the meantime, the Netherlands is focusing on creating more opportunities for institutions to exchange information among themselves. Knowledge sharing increases the visibility of financial and economic crime.

Risk-based supervision

Risk-based supervision

Supervision is aimed at compliance with laws and regulations. Institutions are primarily responsible for fulfilling promises made to customers and for preventing involvement in financial and economic crime. We choose to deploy our supervisory capacity where the risks are greatest. In addition, we work more frequently with fellow supervisors in Europe to solve cross-border issues, for example in the area of financial and economic crime.

Institutions are primarily responsible

Financial institutions have a strong interest in trust in their financial health and their integrity. It is therefore crucial that they honour promises and obligations. Moreover, society expects financial institutions not to be involved in financial and economic crime. Compliance with laws and regulations and maintaining public trust is first and foremost a task for institutions themselves. This task extends from the workfloor of institutions up to the highest management levels.

Customers, members, participants and policy holders of financial institutions count on their money being handled with care. The high level of responsibility of institutions becomes apparent when the scale of the various sectors is considered. At the end of 2019, the largest three sectors which DNB supervises – banks, insurers and pension funds – had a combined balance sheet total of no less than EUR 4,743 billion.

Legal frameworks and supervision are complementary

Legal standards aim to safeguard trust in sound and honest institutions. Examples of important legal frameworks include the Financial Supervision Act (*Wet op het financieel toezicht – Wft*), the Pensions Act (*Pensioenwet – Pw*) and the Anti-Money Laundering and Anti-Terrorist Financing Act (*Wet ter voorkoming van witwassen en financieren van terrorisme – Wwft*). Legal frameworks support public trust. They provide clarity to institutions as to the requirements to be met and provide the legal basis for the supervision of financial institutions.

As a supervisory authority, we check whether institutions comply with the legal requirements. Our supervision consists of two pillars: prudential supervision and integrity supervision. Prudential supervision aims to ensure the soundness of financial enterprises and a stable financial system. We see to it that institutions can make good on their promises, for example by paying pension benefits, safekeeping savings or covering risks.

Integrity supervision aims to ensure an honest financial sector, by strictly checking that institutions adequately prevent financial and economic crime. An example would be institutions' obligation to report unusual transactions they notice in their systems. In addition to DNB, the Dutch Financial Markets Authority (*Autoriteit Financiële Markten – AFM*) also supervises the financial sector. The AFM focuses on conduct supervision and transparency of markets.

DNB aims to remove ambiguity concerning legal requirements, so that institutions know where they stand. The law has both 'closed' and 'open' standards. In the case of a closed standard, there is virtually no room for divergent interpretations of the rules. For example, the required size of a bank's core capital is a closed standard, as it is explicitly laid down in the law. Open standards have a more general thrust. In the case of open standards, there is room for institutions to determine how to implement them. This may lead to uncertainty concerning what is expected of institutions.

In order to overcome this, we publish examples of how institutions can meet such open standards on our Open Book on Supervision[5] pages. These examples, however, are not rules. Institutions can also comply with the open standard in other ways, as long as they can show that their way of doing so is also consistent with the law.

Supervision cannot fully eliminate risks

The public derives its trust in institutions partly from the legal requirements imposed on those institutions. The prudential legal frameworks recognise that financial institutions face inherent risks that cannot be fully absorbed by capital. For example, the capital requirements for banks and insurers are based on calculations which assume that financial setbacks can be absorbed within a 99.5% confidence interval.[6] With regard to pension funds, the requirements even allow a temporary negative asset position. This approach recognises that risks cannot be reduced to zero. The basic principle of supervision is that institutions are expected to know and manage their risk profile.

Good supervision promotes the resilience of institutions and thereby contributes to trust, but it offers no guarantee against the failure of institutions. The failure of a financial institution may jeopardise the stability of the financial system. The aim of our supervision is to reduce the likelihood and impact of an institution's failure. By ensuring the soundness and integrity of institutions, we contribute to trust in institutions. However, we can never rule out that an institution may fail.

If an institution is no longer viable and resolution becomes necessary, it is important that this be performed in an orderly manner. It is paramount that promises made to customers, members, policy holders and the like are kept as much as possible. That is why we are constantly developing recovery and resolution plans to limit the damage to a minimum in case of a failure.[7] In addition, for banks the deposit guarantee scheme can be activated to compensate account holders.

5 See the Open Book on Supervision.
6 The above refers to losses that occur once every two hundred years according to models.
7 For most financial institutions, liquidation remains the method of choice. Resolution planning offers a solution for banks and insurers that cannot go bankrupt without large ripple effects for the financial system as a whole.

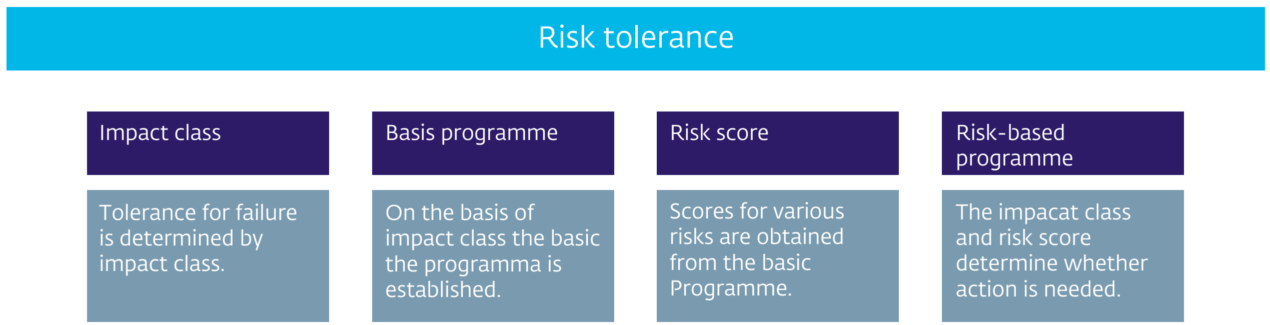
Supervisory intensity is determined on a risk basis

We provide appropriate supervision while realising that this must be performed at acceptable costs. To that end, we deploy our available supervisory capacity there where the biggest prudential and integrity risks are. The intensity of supervision increases as the materialisation of risks has greater implications for public trust in the sector. An important motivation for this risk-based approach is the desire to deploy the available supervisory capacity as effectively and efficiently as possible. In recent years, we have updated our supervisory methodology, bringing it more into line with the ECB's supervisory approach. Figure 1 provides a schematic outline of our updated supervisory methodology. Its basis is risk tolerance, followed by the impact classes, the basic programme, the risk score and the risk-based programme including any interventions.

The intensity of supervision of institutions depends on the impact class to which it belongs. The impact class in turn depends on the importance of the institution to the stability of the financial system. We distinguish between impact classes for prudential supervision and for integrity supervision. Institutions are subject to a heavier regime of integrity supervision if they are an important gatekeeper for the financial system or if they are at high risk of financial or reputational damage in case of an integrity failure. Classification within a prudential impact class depends among other things on the scope of the institution's activities, its national systemic relevance and the social function of the activities.

Institutions in higher impact classes are covered by a more intensive basic programme. For institutions in impact class 1, the lowest class, we foresee limited impact on the stability of the financial system in the event of failure, for example because the institution concerned has little systemic relevance. The starting point is *adaptive supervision*, where supervisors contact an institution if there is reason to do so. Indications to do so can come from reports, but also from samples or messages from inside or outside the institution. We recognise that this approach allows risks to go unnoticed. Intensified monitoring of these institutions would however lead to costs which are disproportional to the limited impact of their failure on the stability of the system. *Active supervision* is the starting point for impact class 2. In addition to reporting, DNB actively maintains contact with institutions to identify risks. Impact class 3 is marked by *proactive supervision*. There is minimum tolerance for failure, given the significant impact of these institutions on the stability of the financial system. The largest banks – also referred to as 'significant institutions' – are in a separate impact class, marked by even more intensive supervision in cooperation with the ECB. There is also a separate impact class for institutions under the supervision of another country which operate in the Netherlands through a European passport. For these institutions, prudential supervision is carried out from the country of establishment and only integrity supervision is assigned to DNB.

Figure 1 Building blocks of supervision



The risks identified in the basic programme may lead to more intensive examination within the risk-based programme. If the risks identified are high, they are examined further within the risk-based programme. In addition, unexpected events at the institutional or macro level may also give rise to further examination. This applies to institutions in all impact classes. In such cases, the supervisory activities are primarily aimed at obtaining a more detailed picture of an institution's changed risk profile. They include examinations carried out at institutions (on-site inspections) and in-depth examinations into the measures taken by institutions to control risks. If we believe an institution has taken insufficient control measures, an intervention is initiated. The instruments available for this range from a supervisory interview aimed at risk mitigation to the use of formal measures, such as fines.

The supervisor's professional judgement partly determines the choice of intervention. This choice depends on the nature and cause of the increased risks and whether there have been any previous supervisory incidents or other factors specific to the institution. The guiding principle in this is that a heavier instrument is used only if it has been argued convincingly that a lighter instrument would be insufficiently effective.

Together in Europe

To a large extent, we operate in a European context. Since 2014, the formal responsibility for the supervision of the large banks has lain with the Single Supervisory Mechanism (SSM), within which national supervisors cooperate under the guidance of the ECB. We also collaborate with the European Banking Authority (EBA) on harmonised banking supervision policies, and with the European Insurance and Occupational Pension Authority (EIOPA) on regulation and supervision regarding insurers and pension funds.[8]

8 In addition, within the EBA, regulation pertaining to investment firms and institutions is being developed. We also collaborate with the European Securities and Markets Authority (ESMA) with regard to financial market supervision and financial stability.

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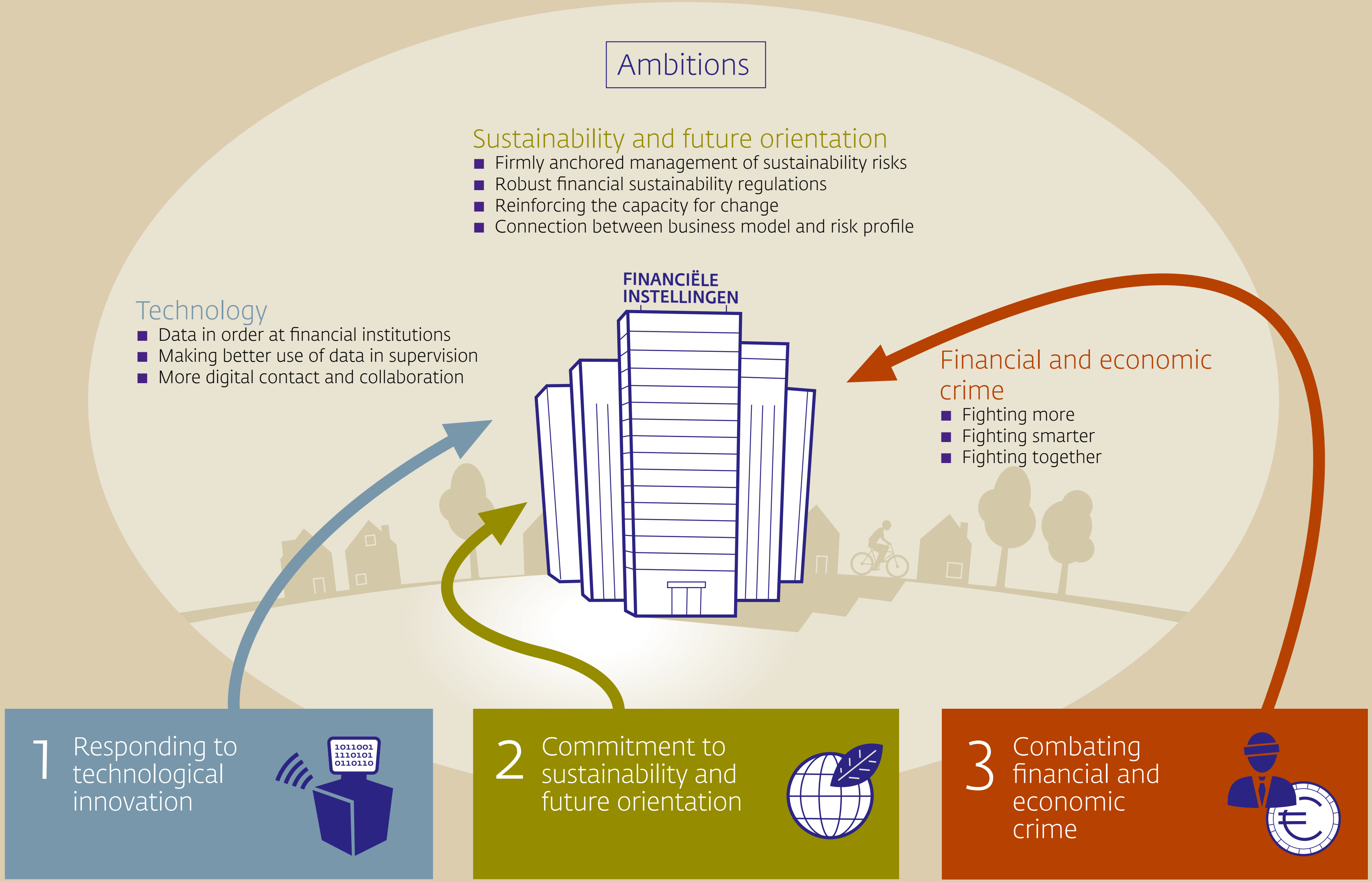

Responding to technological innovation

Responding to technological innovation

New technologies and digitalisation are causing fundamental changes in the financial sector. Because of this, the data of financial institutions must be in order in terms of quality, security and use. Good data are also essential to the strategic direction of institutions. We also invest in improved use of data in supervision. It is our ambition to handle as many standard reports as possible digitally and to work with institutions on the responsible use of new technologies, such as artificial intelligence.

Ambition: data in order at financial institutions

The use of available data offers institutions many opportunities, but also calls for safeguards to manage new risks. Good data quality and proper organisation of data management should be a priority for institutions. The management of operational risks deserves special attention. For example, data must be well protected against fraud and cyber attacks, but also to prevent system failure. In addition, consumers' rights to privacy must be taken into account by institutions when using data.

We will call institutions to account for the quality of their data more. In the coming years, we aim to explore ways to perform supervisory checks using a direct link to institutions' systems, rather than through reports submitted to DNB. A prerequisite for the success of this approach is that institutions' data must be available and of good quality. Regrettably, this is not yet the case for every institution. Because insufficient data quality leads to vulnerabilities in core processes, improving data is also in the interest of the institutions themselves.

Securing data and IT infrastructure against cyber attacks requires a continuous investment in resilience. Financial institutions, their critical service providers and other vital sectors are increasingly being targeted by cyber attacks. During the coronavirus crisis, this trend continues unabated. Institutions and their service providers must be able to demonstrate that their information security is in order[9] and must regularly test their cyber resilience. Managing the increased risks requires improving the knowledge of institutions' management and supervisory board members regarding IT and cyber risks.

The rise of artificial intelligence (AI) is causing a transformation of the way in which financial institutions operate. Chatbots, for example, are used to communicate with customers. Another example is that risk models can be fed transaction data or unstructured text data in order to gain insight into customer behaviour and the concomitant risks. However, the application of AI also entails risks, for example when it is unclear how AI arrives at certain outcomes or when AI appears to discriminate unintentionally. Responsible use of AI involves aspects such as soundness, accountability, fairness, ethics, expertise and transparency.[10] Institutions must implement adequate control measures to mitigate the risks of algorithmic analyses and moreover always be able to explain the results of such analyses.

In the case of outsourcing, institutions remain responsible for risk management and compliance with laws and regulations. Institutions increasingly transfer their data and IT processes to third parties that are not supervised by DNB. However, institutions themselves remain responsible for data security and compliance with regulations at all times. We pay

9 See our Information Security Q&A.
10 See General principles for the use of Artificial Intelligence in the financial sector, DNB, 2019.

particular attention to a specific form of outsourcing, where IT processes run on cloud service providers' servers. In the coming years, we will monitor whether these outsourcings comply with the outsourcing guidelines published by EBA[11] and EIOPA[12]. In practice, we notice a positive development thanks to the deployment of independent IT auditors in the assessment of cyber security and outsourcing measures.

Prudent handling of consumer data is essential for consumer confidence in institutions. Institutions are expected to handle personal data carefully based on the law. Relevant to this is the General Data Protection Regulation, which the Dutch Data Protection Authority (*Autoriteit Persoonsgegevens – AP*) supervises. The revised Payment Services Directive (PSD2) provides that non-banks may also be given access to payment data with the account holder's permission. At all times, data should be prevented from falling into the hands of third parties without permission. Incidents in this area may not only lead to reputational damage and customer loss, but also legal costs or deposit outflows. We are paying attention to this in our supervision in view of the major prudential impact this could have.

Ambition: making better use of data in supervision

We consider data to be a crucial tool for proper and efficient supervision. That is why our supervision is data-driven. In the coming years, we will further improve our data-driven approach by focusing on more efficient use of our supervisors' methods and skills. The purpose of these efforts is to obtain a more complete picture of an institution's risks more rapidly and make supervision more efficient. This will help institutions by reducing the indirect costs of supervision. Many monitoring processes now still require multiple steps of data exchange and contact between institutions and DNB, for example the provision of mandatory reports, licence applications and assessments. We are working together with institutions to find ways to save costs through digitalisation, for example by combining European reporting requests.

Data-driven monitoring enables the sharing of performance standards with institutions. We possess data that are valuable to institutions, relating to cost efficiency or balance sheet composition, for example. We aim to make these data available at the aggregate level in consultation with the sector. Among other things, this information enables institutions to compare specific parameters with their counterparts.

In the coming years, we also intend to increase the use of smart algorithms and AI in our supervision. Due to increasing data availability, manual analyses are no longer possible or desirable, for example because data are becoming more granular and unstructured. Using smart IT tools such as algorithms, targeted data analytics and process mining techniques, we will be able to analyse the increasing amounts of data from institutions in an increasingly transparent and consistent manner. This ensures that we will gain a better understanding of risks faster, identify links between risks, and use automatic analysis and signals.

11 See the EBA guidelines on outsourcing
12 See the EIOPA guidelines on outsourcing

Ambition: more digital contact and collaboration

In the future, institutions will mainly communicate with DNB digitally, via the MyDNB portal. We want to communicate with institutions clearly, efficiently and safely about applications, reports, reviews and other matters. The digital MyDNB portal ensures automatic record-keeping. Institutions and DNB always have the same up-to-date overview of supervisory requirements, applications, follow-up actions and the like. By communicating transparently, securely and without duplication, indirect supervision costs are reduced. For example, institutions can report directly via a standard procedure that data have been requested earlier. Supervisors moreover gain a better understanding of the history of requested data.

The iForum aims to be the connecting link to the sector and a catalyst for technological innovation. The iForum's design[13] ensures a close dialogue with the sector, creating a shared overview of opportunities and risks of technological developments, including supervision bottlenecks. For this purpose, we want to set up pilots together with institutions, to test on a small scale whether an innovation is effective for both institutions and DNB before its introduction is decided on. The Innovation Hub and the Regulatory Sandbox programme will also continue through the iForum. Through the Regulatory Sandbox, we conduct a targeted dialogue with institutions that experience obstacles to applying innovations. The aim is to remove ambiguities about the implications of legislation, so that innovations can flourish.

13 For the purpose and design of the iForum, see the founding charter.

Commitment to sustainability and future orientation

Commitment to sustainability and future orientation

Managing sustainability risks is essential to a future-oriented business model. That is why, first of all, supervision aims for a firmer anchoring of sustainability in risk management at institutions. Secondly, we are working in Europe on robust financial regulation regarding sustainability. Thirdly, reinforcing institutions' capacity for change is a focus. Lastly, institutions' risk profiles must remain in line with their business models.

Sustainability

Ambition: firmly anchored management of sustainability risks

Sustainability risks require adequate management. More insight has been gained in recent years into the exposures that banks, insurers and pension funds have to various sustainability risks. Initially, the focus was on managing risks stemming from climate change and other ecological changes that could have substantial financial impact, such as biodiversity loss.[14] This resulted in the first steps towards the integration of sustainability in supervision. In the coming years, we will further anchor the management of material sustainability risks in our supervision. Risks are to be identified by institutions, while we will ensure that adequate control measures are taken. We will develop an appropriate set of future-oriented supervision instruments for this purpose. In addition, we will supervise the identification and restoration of data gaps. We also wish to contribute to the development of more precise methods to measure financial climate risks. Financial institutions are expected to be transparent about the manner in which they take sustainability into account in important decisions, for example regarding their investment policy or lending.

We maintain an active dialogue with institutions on managing sustainability risks. The expectations that we, as a supervisor, have with regard to the management of sustainability risks are clearly and transparently communicated to institutions. An institution-specific approach is explicitly applied here. At the same time, we actively engage in dialogue with institutions about possible obstacles from our side which they experience when making their activities more sustainable. Best practices identified during this dialogue can be provided as feedback to institutions.

By conducting research, we encourage the sector to devote more attention to sustainability risks. In recent years we have made various analyses to map out how climate change, the energy transition and other societal and environmental challenges can affect financial institutions.[15] In the coming years we will continue to investigate this.

14 See Indebted to nature – Exploring biodiversity risks for the Dutch financial sector, DNB, 2020.
15 See also 'Values at risk? Sustainability risks and goals in the Dutch financial sector', DNB, 2019, and 'Waterproof? An exploration of climate-related risks for the Dutch financial sector', DNB, 2017.

Ambition: robust financial sustainability regulations

We are actively involved in shaping international financial regulation regarding sustainability risks. Over the coming years, we also wish to contribute to the creation and implementation of international regulation aimed at better managing sustainability risks. These may include international standards such as those of the Basel Committee on Banking Supervision (BCBS) and European guidelines such as those of the European Banking Authority (EBA). In doing so, we are committed to further developing BCBS standards and the EBA guidelines for the identification of sustainability risks at banks. In addition, the methodology we developed for climate stress testing will be further developed at the European level. This is necessary to better understand the impact of a disruptive energy transition on the financial sector, for example. Ultimately, the ambition is to deploy this methodology as broadly as possible internationally.

We encourage collaboration in the field of sustainability at the national and international levels. As one of the founders of the Network for Greening the Financial System (NGFS), we have been working since 2017 to improve collaboration between central banks and supervisors in the field of sustainability risks At year-end 2020, 83 central banks and supervisors as well as thirteen observers have joined the NGFS, exchanging experiences and making recommendations to integrate climate-related and environmental risks into the core tasks of central banks and supervisors. As the Chair of the Dutch Sustainable Finance Platform, we encourage collaboration at the national level. Within this partnership, the financial sector, supervisors and government ministries are tackling sustainable-financing challenges.

Future orientation

Ambition: reinforcing the capacity for change

A lack of capacity for change often reveals itself slowly, but will gradually erode a business model. The environment in which financial institutions operate is changing rapidly, requiring institutions to adapt quickly to keep their business models future-proof. If margins fall, or if the services offered are no longer in line with market demand, this does not have to impact institutions immediately. But in the longer term, the consequences can be detrimental. Institutions must be able to anticipate and cope with changes. The ability to change involves more than just the strategic choices that institutions make. There must be a capacity for change at all levels in the organisation, from workfloor practice to the board of directors. It is also a matter of operational agility. For example, in the coming years, pension providers will be facing the challenge of making the necessary preparations to implement the new pension contract.

Ambition: connection between business model and risk profile

Business models change as the market does, but that should not result in unmanageable risks. During the regular supervisory interviews and on-site checks, much attention is paid to changing business models. The question is always whether institutions are able to remain within their own defined risk profile with their exposure to risks. The basic principle is that risk profiles should be appropriate, given institutions' societal function. Another question is which activities and components are important for the profitability of a financial institution and whether these are sustainable for the future. Especially at this time, when business models can change rapidly due to the coronavirus crisis, this remains a point for attention.

Combating financial and economic crime

Combating financial and economic crime

Know your risks, your customers and their transactions, and ensure that your institution is not used for illegal purposes – that is, in brief, the assignment which the Anti-Money Laundering and Anti-Terrorist Financing Act (*Wet ter voorkoming van witwassen en financieren van terrorisme – Wwft*) gives to financial institutions and which we supervise.

Both society and politicians call for a firm approach to financial and economic crime. We are therefore committed to more, smarter and more international action against these forms of crime, which include money laundering, corruption, terrorist financing, sanction violations and fraud. This is a challenge, as criminals always find new ways and means to hide the proceeds of their illegal and harmful activities.

Integrity supervision is intensifying in order to combat money laundering and terrorist financing. The fight against financial and economic crime calls for urgency. Improvements are possible by making increased use of modern techniques and by collaborating better within the limits of the law. This will make the fight smarter. A more international approach would also be beneficial. Criminals operate internationally; institutions and supervisors should do the same. Moreover, international harmonisation of supervision will prevent criminals from moving their activities to jurisdictions where supervision is insufficiently rigorous or has insufficient resources

Ambition: fighting more

Institutions are taking their gatekeeper role more seriously, but challenges remain. In recent years, institutions have further strengthened their gatekeeper role and invested in human and other resources to keep criminals out of our financial system more effectively. At the same time, there is still much room for improvement to the structural performance of the gatekeeper function. Societal interests are great in this respect. We will therefore continue to closely monitor that financial institutions take appropriate measures to prevent involvement in financial and economic crime in the coming years.

As a supervisor, we appeal to directors concerning their responsibilities in combating financial and economic crime. For example, we expect directors to know, understand and control the integrity risks that their institutions are facing. However, supervisory practice shows that ownership of this is often limited to the compliance function, and to a lesser degree the audit function. Robust defence lines, starting at the commercial components of institutions, with clear ultimate responsibility by the board, are necessary. The management board of an institution should include a policymaker responsible for ensuring compliance with the Wwft. Under the Trust Offices Supervision Act 2018 (*Wet toezicht trustkantoren 2018 – Wtt*), trust firms must have an independent and effective internal compliance function. We monitor compliance with these requirements and will take a strong stand in the coming years in the event of violation of these new requirements.

In case of a breach of legal standards, we may re-assess directors. We can reassess the suitability and reliability of relevant policymakers in the case of criminal proceedings, or when appropriate. This is an important tool to ensure the integrity of institutions and confidence in their proper functioning. We can also fine actual executives in case of criminal investigations if necessary.

Formal enforcement measures for institutions, including fines, will be publicly disclosed. This means society will be informed about insufficient compliance by the institutions concerned. On the basis of this information, customers can decide whether or not to engage in business with these institutions. The disclosure obligations for formal measures in the

Financial Supervision Act (*Wet op het financieel toezicht – Wft*), the Anti-Money Laundering and Anti-Terrorist Financing Act (*Wet ter voorkoming van witwassen en financieren van terrorisme – Wwft*) and the Trust Offices Supervision Act 2018 (*Wet toezicht trustkantoren 2018 – Wtt*) also give institutions a further incentive for acting in compliance with the law.

Ambition: fighting smarter

We contribute to public-private partnerships in the fight against financial and economic crime. If private parties and the public investigation and supervisory partners work together, smarter crime fighting will be possible. Combined data and analysis capacities can increase the visibility of criminals' complex financial flows. We support a number of public-private initiatives, for example through the Financial Expertise Centre.[16]

We also encourage private collaborative initiatives to keep criminals out of the sector. One example is the partnership of Dutch banks called Transaction Monitoring Netherlands (TMNL). However, such initiatives as TMNL must be compatible with effective compliance with laws and regulations. Pooling data analysis capacity has much potential, but is still in the early stages. Supervision of the approach to fighting financial and economic crime taken by individual institutions will remain a necessity.

We have been actively involved in the supervision of two types of crypto service providers. The first group concerns providers of services for the exchange of virtual and fiduciary currencies. The second group concerns providers of custodian wallets for virtual currency. In order to properly organise the supervision, an infrastructure has been set up for registration of these parties. The Open Book on Supervision was recently expanded with a separate section where these providers can find relevant information about supervision.[17] With the foundations in place, we will continue to exercise risk-based supervision of this sector in the coming years.

Ambition: fighting together

Financial and economic crime is an international problem that calls for cooperation across national borders. Many structures used by criminals extend across several countries. This applies in particular to the misuse of crypto assets. We are therefore driving targeted collaboration between European supervisors in this area. We are also working on a solid international supervision network.

The prevention of financial and economic crime requires a level playing field. Effective supervision requires equal effort and identical interpretations of the standards framework by supervisors. Criminals will seek out the lightest supervisory regime, moving the problem to specific countries. That is why we are committed to an effective approach at the international level. Together with the Ministry of Finance and the AFM, we advocate a European supervisory authority on financial and economic crime.[18]

Within the borders of the Kingdom of the Netherlands, we are working to curb financial and economic crime through the overseas territories. The first steps have been taken to tighten the integrity regulations on Bonaire, Sint Eustatius and Saba, including the obligation to publicly disclose formal measures. In the coming years, we will continue to strengthen appropriate supervision within the kingdom.

16 See the website of the Financial Expertise Centre.
17 See the Open Book on Supervision for crypto service providers *here*.
18 Read about the efforts by DNB, AFM and the Ministry of Finance to achieve this here (in Dutch).

Authors
Thomas van Galen & Jacob Dankert

Includes contributions from:
Patrick de Neef, Nikki Rupert, Sander van Wesemael, Melvin Zelissen
and Jitske Zoethout

DeNederlandscheBank
EUROSYSTEEM