AFM publishes its Trend Monitor 2021

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On 3 November 2020, the Dutch Authority for the Financial Markets (**AFM**) published its Trend Monitor 2021. The Trend Monitor 2021 consists of an overview of trends and related risks that, according to the AFM, will have an impact on the Dutch financial sector and the AFM's supervision in years to come. In this newsflash we summarize the identified trends/risks and supervisory themes.

In its foreword, the AFM first draws attention to the ongoing impact of the coronavirus. According to the AFM, the coronavirus pandemic would appear not only to have delayed any possible return to a higher interest rate for a couple of years. It has also seemed to have accelerated the pace of digitisation (due to increased working and consumption from home) and to have offered governments opportunities to make new arrangements regarding sustainability in affected sectors. The AFM furthermore notes that countries may have to deal with a higher likelihood of epidemics as a result of increased travelling and people and animals living more closely together. Consequently, another coronavirus or other pandemic is not unforeseeable, which supports the notion that resilience needs to be built into the financial system, even if this comes at the expense of other objectives worth striving for.

The AFM continues to describe five trends that may impact the financial sector and AFM supervision:

- **Macroeconomic developments**: As a result of the coronavirus pandemic, the Dutch economy is experiencing a period of unprecedented contraction that is accompanied by rising unemployment. The AFM sees that the crisis is testing the financial resilience of financial institutions and households alike. Combined with the effects of the ongoing low interest rate, this economic headwind is increasing the pressure on the profitability and solvency of financial institutions, with the risk that institutions will focus less on their customers' best interests. Households may face a sudden fall in income and thus encounter difficulties meeting payment obligations. Moreover, the ongoing low interest rate is prompting investors and financial institutions to take higher risks in their search for yield.
- **Geopolitical developments**: The AFM indicates in this regard that a hard Brexit remains a risk to the stability of the markets. At a global level, multilateral cooperation between countries is under pressure, which unilateralism is shown in long-running trade disputes.
- **Developments in legislation and regulation**: Here, the AFM highlights the Dutch pension agreement reached in 2020, as a result of which 'guaranteed pension rights' (defined benefit) will no longer be accrued and pensions will depend more directly on investment results (defined contribution). In addition, the AFM points out that new proposals with regard to digitisation (e.g. the regulation of markets in crypto-assets (MiCa)) and sustainability (resulting from the EU Action Plan for Financing Sustainable Growth) have a prominent place in the European legislative and regulatory agenda.
- **Digitisation of the financial sector**:

– The AFM sees an increased availability and usage of data. The ability to link these data to artificial intelligence (**AI**) and other technology has led to the emergence of new earnings models. The policy-driven move towards open banking, and in the future towards open finance, is contributing further to this development. According to the AFM, these developments bring more new players into the financial sector, including ‘big techs’. With a combination of large customer bases, powerful brands and huge financial reserves, the AFM hold it likely that these big techs will be fully engaged in the financial services sector, resulting in very strong competition for the banking sector and other financial services providers.

-Another global trend identified by the AFM is that both established and new market participants are investing in distributed ledger technology (**DLT**) (of which the best example is blockchain) and smart contracts, which potentially offer smarter and more efficient ways of processing transactions and storing data. The AFM refers to existing use-cases – including the joint venture between Banque de France and Société Générale for the issue and settlement of a bond via a public blockchain – which illustrate how the application of DLT makes it possible to simplify the market infrastructure, accelerate issue and payment processes and strengthen security. The AFM points out that despite these potential benefits, this technology involves risks that cannot yet be sufficiently controlled, nor can the relevant regulatory requirements be met in all cases. Accordingly, the AFM welcomes the development of a pilot regime by the European Commission for DLT-applications on trading platforms. Such an EU-framework can assist supervisory authorities in permitting experimentation without breaching existing EU-regulations.

-The AFM also addresses the increased use of AI, especially in the insurance sector but also in other sectors within the financial sector. In the coming period, the AFM plans to formulate its expectations with respect to the responsible use of AI and at the same time to strengthen its supervision in relation to this technological development.

- **Transition to a sustainable economy and society**: Lastly, the AFM has identified the trend that the market for sustainable financial products and investments is growing. The AFM believes that the main challenge concerns the availability and quality of the information provided on sustainability risks and performance. The AFM expects that the European legislation that is currently being drafted will improve the availability, reliability and comparability of sustainability information.

Based on the above trends, the AFM has formulated three supervisory themes for 2021:

1. **Responsible mortgage lending**: The AFM sees a conflict between the aim of preventing excessive borrowing on the one hand and other policy objectives on the other hand, such as making the housing market more sustainable and improving the opportunities for first-time

buyers. Secondly, the AFM has identified that some households have existing payment obligations (for example student loans) that may possibly not be taken into account by lenders when determining the maximum financing burden on a mortgage application. Both issues have the attention of the AFM.

2. **Competition between exchanges and trading platforms in a single European capital market**: As a result of Brexit, several large trading platforms have chosen to relocate to the Netherlands, making policy developments in the area of trading infrastructure even more relevant for AFM's supervision. With regard to share markets, the AFM considers that one of the important considerations in the revision of MiFID II should be to level the playing field between trading platforms and systemic internalisers. With regard to bond markets, the AFM believes it is important to look closely at which transparency requirements are appropriate. If requirements get in the way of market liquidity, they could have a negative effect on pricing and liquidity. In addition, the AFM argues that policymakers and supervisory authorities need to consider how they can contribute to the standardisation of bonds, in order to create a more liquid European bond that is attractive to both private-sector bond issuers and investors.
3. **Effects of data usage on the structure of the financial market**: Lastly, the AFM points out that the use of data is becoming an increasingly important production factor in the financial sector. According to the AFM, this development is changing both the way in which financial institutions organise themselves as well as the market structure in which these businesses operate. The quantity and diversity of new partnerships in this regard, could lead to new operational risks. While the increase in data usage can offer benefits to consumers, it can also lead to data being used against their interests, for instance in the form of personalised product pricing. Accordingly, the AFM seeks to engage in dialogue with the market on how data techniques can best be applied in the interests of consumers. The increase in the processing of personal financial data means that closer cooperation between supervisory authorities is needed. While initial steps have been taken to a closer cooperation between the AFM, the Dutch Central Bank and the Dutch Data Protection Authority, the AFM acknowledges that finding an appropriate form of cooperation remains a challenge.

Next steps

The Trend Monitor 2021 contributes to defining the supervisory priorities of the AFM. The AFM has indicated that the practical implications of these trends and risks for the AFM's supervisory activities will be detailed in the AFM Agenda 2021, which is expected to be published in early 2021.

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