Module Supervisory themes DNB

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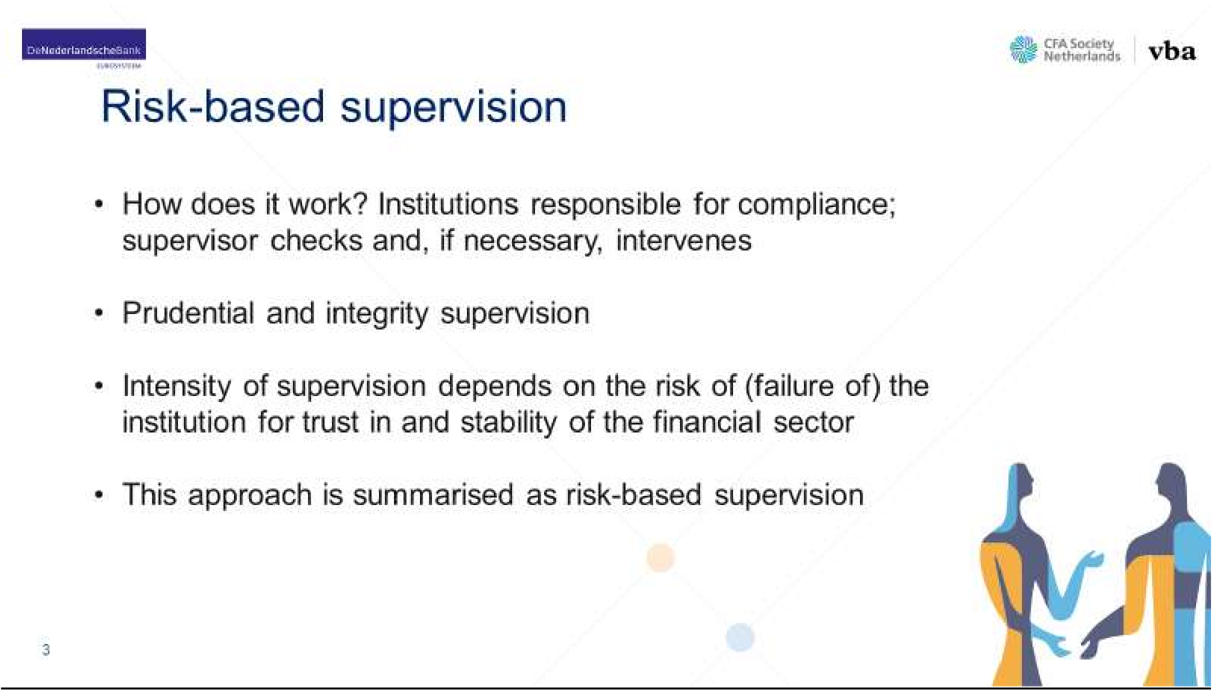
DNB has recently updated its Supervisory Strategy to cover the years 2021 to 2024. In this video, I will shortly explain the focus areas of our supervision in the coming years. However, these are areas that we think warrant extra attention. However when new risks emerge, or a crisis erupts, such as the outbreak of coronavirus last year, we will adjust our supervisory attention accordingly to deal with these new risks. A lot of our attention therefore still goes to the economic impact of the coronacrisis on the financial sector, where we keep a close watch on for instance liquidity and credit risk. This approach is summarized as risk-based supervision. So how does this work?



Supervision is aimed at compliance with laws and regulations. Financial institutions, and you as their employee, are responsible for fulfilling promises made to customers and for preventing involvement in financial and economic crime.

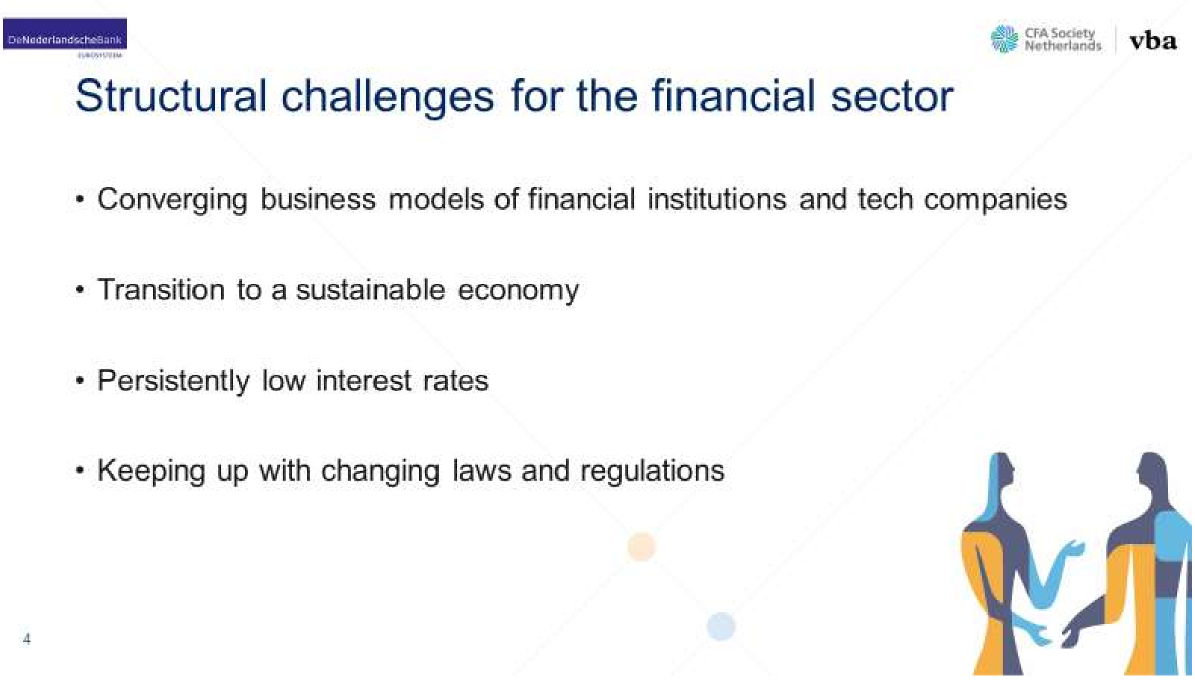
As a supervisory authority, we check whether institutions comply with the legal requirements. Our supervision consists of two pillars: prudential supervision and integrity supervision. Prudential supervision aims to ensure the soundness of financial institutions and a stable financial system. We see 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.

We choose to deploy our supervisory capacity where the risks are greatest. This works as follows. We categorize institutions in *impact classes*, depending on the tolerance for failure. For example, tolerance for failure for a big bank is very low; the impact on financial stability and trust in the financial sector would be too great to allow such a bank to fail. For a small asset manager, the impact on trust and financial stability would be a lot smaller, were it to fail. The intensity of our supervision is based on this assessment.

We then follow a basis program of supervision for each institution, which may be extended with a risk-based program if risks at certain institutions are perceived to be worthy of further investigation or intervention.

The basis of our work is looking at risk categories such as credit risk and liquidity risk. When the COVID-19 crisis broke out, the first focus was ensuring that financial institutions had enough liquidity, and credit risk also got increased attention. The next couple of years institutions will still have to deal with the economic impact of the crisis, especially when government support for the economy is gradually reduced.

However, structural challenges abound. The business models of financial institutions are changing, whereby they and technology companies increasingly converge. Tech companies are offering financial services, whereas financial services are more and more serviced online. The COVID-19 crisis has accelerated this trend to digital. Boundaries between supervised entities and not-supervised entities are blurring; whereby large parts of for instance back-office services, critical to a financial institution, are outsourced to third parties.



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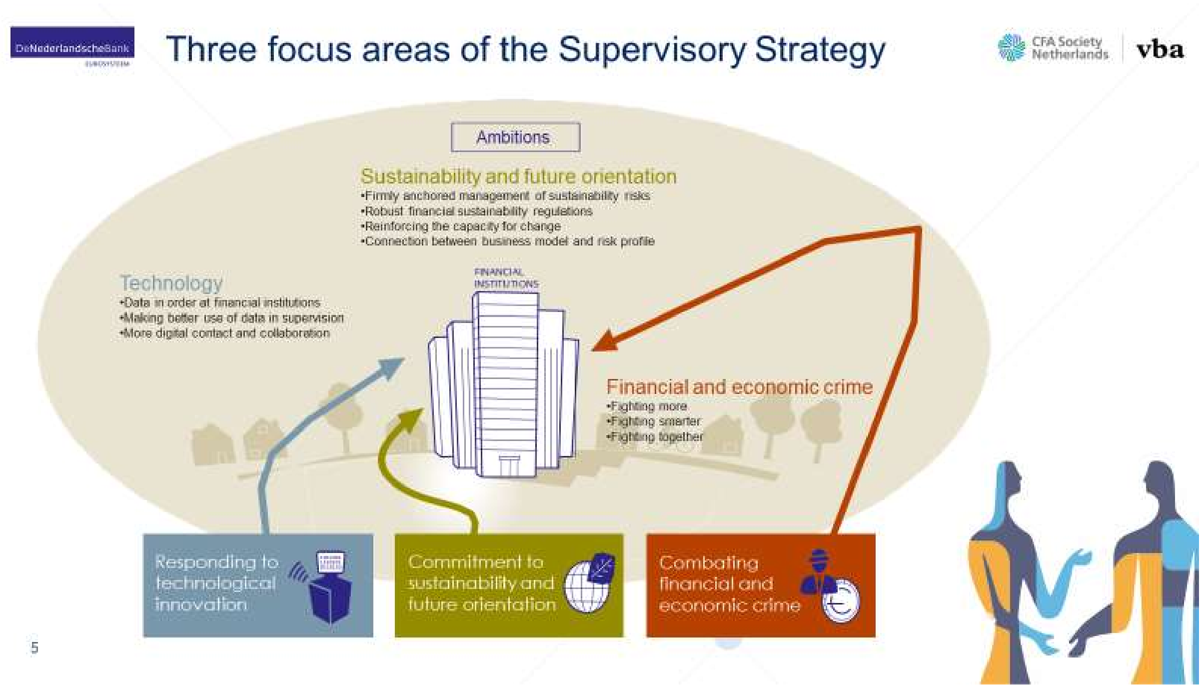
A second structural challenge is for the financial sector to finance the transition to a sustainable economy. There are plenty opportunities and a big financing need. At the same time, there is a need for adequate management of climate and environmental risks.

Persistently low interest rates may be a feature of the coming decade. The past decades has seen a gradual, but persistent, falling of interest rates across the world. Banks need to become more resilient by making their business model less dependent on interest income. The challenge for insurers in the coming years will be to achieve sufficient returns to pay out the benefits they have promised. Also, selling new insurance policies with high premiums and low returns will be hard. For pension funds, the new system no longer commits to pension entitlements, thus shifting risks to the participants. However, this calls for clear communication and implementation of a future-proof contract that works if interest rates stay low.

Furthermore, institutions are faced with changing prudential legislation. As an example, 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. Big changes are expected in EU regulation however. 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 and European supervisory authority in this area.

Finally, on top of the regular, bread-and-butter type supervision, we highlight three areas of extra attention.



First, new technologies and digitalization 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. 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 particular attention to a specific form of outsourcing, where IT processes run on cloud service providers' servers. This can create dependency of financial institutions on third parties, whereby the continued soundness and operation of financial institutions is more and more reliant on unsupervised service providers. In the coming years, we will monitor whether these outsourcings comply with the outsourcing guidelines published by EBA and EIOPA.

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. Also, communication and collaboration will increasingly be done digitally. COVID-19 has made this even quicker than we anticipated; we don't foresee a return to the old ways of communicating after COVID-19 has receded.

Commitment to sustainability and future orientation is the second area of extra attention. 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. A lack of capacity for change often reveals itself slowly, but will gradually erode a business model. In light of the persistently low interest rates, there is less 'margin' for institutions to wait-and-see. Adaptability is important.

Lastly, combating financial and economic crime will see an extra impulse in supervisory capacity. Financial and economic crime includes money laundering, corruption, terrorist financing, sanction violations and fraud. The Netherlands has a very well developed financial system, with great connectivity to the international financial system. Criminals would like to use this, for instance to launder money obtained in drug trafficking or through fraud. Financial institutions really need to know-their-costumer, to make sure our financial system is not misused.

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We need to fight more, 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.

We also need to fight smarter. We contribute to public-private partnerships in the fight against financial and economic crime. 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). In TMNL, from this year the participating banks will jointly monitor transactions to increase detection of suspicious transactions and make it easier to follow up on them by the relevant authorities.

Finally, we need to fight better internationally. Financial and economic crime is an international problem that calls for cooperation across national borders. 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.

So that was a brief introduction to the supervisory themes of DNB. If you want to read more in depth on the themes I highlighted, you can go to the DNB website where you can find our Supervisory Strategy for 2021-2024. Thank you for watching!