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Approaches and developments

The Dutch tech scene

The Netherlands, particularly the cities of Amsterdam (fintech) and "brainport" Eindhoven (high tech), have emerged as frontrunners in the global tech scene. This has created a robust ecosystem of like-minded companies and an influx of many talented individuals from all around the world. This position has been further cemented by Brexit, which has attracted many fintech companies to the Netherlands as a gateway to continental Europe due to its proximity to London, excellent (digital) infrastructure, favourable tax schemes, and widespread English proficiency. This is reflected in, amongst others:

- Amsterdam is host to Money 20/20 Europe, Europe's largest and most important fintech event;
- the Netherlands ranks fifth on the Global Innovation Index 2022. The Netherlands is considered an ideal location for companies to accelerate their business and develop next-generation solutions;
- the Netherlands is an "Innovation Leader" according to the European Scoreboard 2022; and
- Eindhoven (located in the South of the Netherlands) ranks seventh when it comes to the most promising global science hubs according to a research report by Dealroom.com. Large multinationals such as Philips, ASML and AMSI have their roots in this region and have become strong strategic partners for all kinds of Dutch tech companies.

The Dutch government supports the continued growth of the (fin)tech sector in the Netherlands and actively strives to improve the Dutch business climate. A recent example is the work on making share option schemes and other incentive schemes fiscally more attractive to start-ups and their staff to better attract and maintain talent.

Euronext Amsterdam, formerly known as the Amsterdam Stock Exchange, has gained increasing popularity over the last couple of years and even surpassed the London Stock Exchange in 2021 as the biggest European stock exchange. Euronext includes three of the largest European tech companies (Prosus, Adyen, and Just Eat Takeaway).

The Dutch fintech climate

The Netherlands is historically strong in "traditional" fintech (payments, asset management, credit provision, etc.). For example, Adyen, a payments platform founded in the Netherlands in 2006, has grown to a fully fledged financial technology platform with a banking licence and a market cap of over EUR 50 billion as of July 2023. Other payment businesses that have successfully raised significant investments in recent years include online-only bank Bunq, payment service provider for SMEs Mollie, customer engagement platform CM.com, and Buckaroo.

Successful "next-generation" fintechs knocking at the door include centralised and decentralised blockchain based companies (e.g., gaming, ticketing, finance), robo-(investment) advice, algorithmic (high frequency) trading. Other areas of significant development in the Netherlands include funds and investment firms with a tech first approach and strong climate/ESG focus.

Towards a digital first society

The Netherlands – along with Finland – is in the lead with the highest amount of cashless payments within the Eurozone. The Dutch Central Bank (**DNB**) is one of the leading forces in European efforts to investigate the potential of a digital euro and a central bank digital currency (**CBDC**), in an effort to keep the European Union at the forefront of digital payments.

The COVID-19 pandemic further increased the speed of the digital transformation within the European Union (**EU**). Dutch regulators expect and support financial undertakings to further digitalise and adopt new technologies for the benefit of their customers, which has further fuelled the growth of fintech ecosystems. However, this increasing shift to digitalisation also presents new challenges, for example, in the area of cybersecurity and access to finance for the non-digital savvy.

Upcoming regulatory changes

In recent years, the European Commission (**EC**) has published EU wide strategies on the EU's digital future, digital finance and more. In order to address the risks and challenges posed by the digital transformation, European legislators have many legislative initiatives in the works. Some of the most notable legislative initiatives addressing the continuing shift to digitalisation include:

- The introduction of the Markets in Crypto-assets Regulation (**MiCA**), the first comprehensive regulatory framework for crypto-assets, crypto-asset service providers and issuers of cryptos-assets (in force since 29 June 2023, applies per 30 December 2024, with some measures even applying already per 30 June 2024). We foresee a competitive advantage for crypto service providers (i.e., virtual asset service providers) that are currently registered in the Netherlands, as they are currently already subject to a relatively strict supervisory authority compared to other European jurisdictions, which means that the transition from a registration to a licensing regime may be less of a transition (at least in mindset).
- The Digital Operational Resilience Act (**DORA**), that introduces requirements for financial institutions to address vulnerabilities in their information and communication technologies (**ICT**) systems. These requirements relate to the management of ICT risks, testing of ICT systems, and better overseeing risks stemming from the usage of third-party ICT providers.
- Other legislative initiatives which will greatly impact fintechs include a major overhaul of the Anti-Money Laundering (**AML**) framework, a framework for Financial Data Access (**FiDA**), the third Markets in Financial Instruments Directive (**MiFID III**), and the third Payment service directive (**PSD3**).

Fintech offering in Netherlands

The Netherlands has been at the forefront of innovative fintech advancements for many years. Traditionally strong in payments, for example, instant online payments, have been the norm in the Netherlands long before the widespread adoption of such systems in other parts of the EU (and the world for that matter). As of today, this trend carries on with the

Dutch fintech industry continuing to expand and grow exponentially. Below we signal some trends.

SME financing

Europe is infamous for its reliance on bank finance for SMEs (compared to the US where much more private capital is available for those companies). In recent years, many new market entrants have emerged in the alternative finance market. Ranging from crowdfunding platforms (an EU crowdfunding regulation opened up new opportunities for cross border activities since last year), fully automated (online) risk assessments for SMEs requiring working capital (typically up to EUR 2 or 5 million), tokenisation of invoices (factoring models), and the issuing of (security) tokens via ICOs.

Decentralised finance

DeFi is definitely on the rise in the Netherlands and the EU as a whole, although we still see many projects struggling with realising their ambitions of full compliance (financial regulatory, data protection, etc.) while leveraging the full potential of Web3.

Artificial intelligence

Fintechs and incumbents alike are increasingly relying on AI to improve their services, for example, by enhancing customer experience, optimising internal operations, and making well-informed (business) decisions. Many fintechs are using AI for customer relationship management, personalised marketing and transaction monitoring, to name a few. A notable example can be found in the lending sector, where AI systems are effectively used for analysing vast datasets to assess the risks associated with loans.

While AI has brought numerous benefits to the fintech sector, its deployment has also raised concerns. Issues related to privacy, algorithm bias, wealth distribution, and the future of employment, among others, have surfaced. The AFM and DNB are actively involved in discussions on these topics, expecting the financial sector to use AI for the benefit of their customers and internal soundness, while prudently addressing related issues. At the EU level, an AI Act is in the making, although discussions are fierce and ongoing.

Open banking and open finance

The second European Payments Directive (**PSD2**) introduced open banking, forcing banks to open up their data in a secure, standardised form to other market parties. After a somewhat slow start, it is now getting more traction. Meanwhile at the EU level, work is progressing for the next step: Open Finance, which should provide data subjects (consumers and SMEs) with even better data access for their service providers. Naturally this comes with challenges in the field of data protection, (cyber) security and ethics (e.g., financial exclusion) to name a few.

DLT Pilot Regime

The EU DLT Pilot Regime provides for what is effectively a sandbox for market infrastructures based on distributed ledger technology. It allows eligible firms to apply to operate a DLT-based trading facility and/or settlement system for financial instruments, within a flexible regulatory environment. The idea is to facilitate the development of secondary market infrastructure for digital securities and to help inform EU regulators as to what (if any) permanent changes to the regulatory framework would be beneficial. Applications are open since 23 March 2023 and will be granted for a period of up to six years (or as long as the programme runs).

AML/CFT compliance

As AML/CFT requirements become more stringent and enforcement actions including hefty fines become more common, the financial sector, especially fintechs increasingly rely on external service providers to meet compliance standards. A noteworthy local hero is Fourthline that provides KYC onboarding solutions.

<u>Backoffice solutions</u>

Perhaps not as visible but increasingly relevant, many fintechs provide services traditionally seen as part of the backoffice of financial undertakings. Adding value in that part of the value chain that the public does not get to see. An example of a local hero is Ophen, a cloud-based core-banking engine.

Regulatory and insurance technology

<u>RegTech</u>

The regulatory burden for the financial sector has increased significantly in the aftermath of the 2007/8 financial crisis, ranging from increased prudential buffers to strict rules on governance and product development. In recent years, supervisory authorities had a strong focus on compliance with AML/CFT rules. Several banks faced scrutiny from the public prosecutor and hundreds of millions of Euros where paid in settlements.

Against this background, many fintechs emerged offering innovative RegTech solutions help financial undertakings comply with financial regulatory obligations. An example is digital identity platform Fourthline that provides user-friendly onboarding in compliance with KYC requirements. At the same time, many financial undertakings, including fintechs, develop AI tools in-house to comply with stringent European legislation. Although supervisory authorities acknowledge and even promote the importance of tech to improve the soundness of "Bank of the free", Bunq recently won a court case against regulator DNB on the use of a new AI based approach for classifying customers in risk categories based for AML purposes, that was followed closely by the industry.

<u>InsurTech</u>

Insurance companies in the Netherlands increasingly rely on data analytics and AI applications. Although most use cases are internal (e.g., improved modelling, early signalling of defaults), public facing examples include robo-advice and chatbot services, and analysing customer texts through text mining. Supervisory authorities DNB and AFM closely monitor developments and expect significant increase in the use of AI and other tech tooling in the insurance sector. Furthermore, DNB is actively engaged in international consultations on AI, ensuring alignment with developments across the European insurance market, as facilitated by the European Insurance and Occupational Pensions Authority (**EIOPA**).

Regulatory bodies

The Netherlands has adopted a "twin peaks model" for financial supervision. Under this model, the AFM and DNB have divided responsibilities for supervising the financial sector, including fintechs. In brief, the AFM is responsible for conduct-of-business supervision and DNB is responsible for prudential supervision.

The AFM's conduct-of-business supervision focuses on ensuring that financial markets operate in a clear and fair manner, with special attention focused on consumer protection. The primary focus of DNB's prudential supervision is ensuring the stability and integrity of the financial system. DNB assesses the financial risks posed by financial institutions such as fintechs, and ensures that they have adequate risk management practices in place. DNB's priorities also include ensuring a secure, reliable, and efficient functioning of the payment system. The AFM and DNB have "divided" the market, in the sense that they each act as the main supervisory authority for different types of market participants. For example, banks, PSPs, pension funds, insurers and CCPs have DNB as their primary supervisor, while investment firms, funds (AIFM/UCITS), financial advisors, crowdfunding platforms and credit offerors have the AFM as their main supervisor.

Fintechs are also subject to supervision by other supervisory authorities for certain specific aspects of oversight.

- The Dutch Data Protection Authority (*Autoriteit Persoonsgegevens*, **AP**) is responsible for supervising fintechs' compliance with the General Data Protection Regulation (**GDPR**). For example, matters such as consent mechanisms and data transfers.
- The Authority for Consumers & Markets (*Autoriteit Consument & Markt*, **ACM**) supervises various aspects of the fintech industry, including sales to consumers and fair competition (including merger clearances). In recent years, the ACM conducted research into perceived anti-competitive practices by banks to keep out fintechs, which was actively followed up.

Key regulations and regulatory approaches

In principle, legislation in the Netherlands is technology neutral. Financial regulations are based on the same activity, same risk, and the same regulation principle. This means that activities are regulated, irrespective of the nature of the service provider. The principle of proportionality determines the extent to which a fintech, incumbent or other financial services actor needs to comply with regulatory requirements. For example, regulatory requirements on governance increase as an undertaking grows and becomes more complex in terms of organisation, products, and services.

Typically, international agreements, such as the Basel Accords and FATF recommendations, are implemented at the EU level following which they are implemented at the national level. The Dutch Financial Services Act (**FSA**) is the main piece of regulation for financial undertakings, including fintechs. The FSA largely stems from European legislation (directives implemented in national law), such as MiFID II, PSD2, Solvency II and CRDV. This means that in practice, even though implementations may differ somewhat per EU Member State, Dutch fintechs are largely subject to the same rules as other EU-based fintechs. That said, national differences between Member States exist also because competent authorities do not always agree between each other on matters of interpretation and implementation. Fintechs that are not regulated themselves may still be indirectly impacted by financial services legislation if their relationship with regulated undertakings qualifies as outsourcing, especially when such relationship is considered material or critical in. Another key piece of legislation for fintechs is the Dutch AML Act, which implements the European AML/CFT framework.

Dutch regulatory authorities address new developments in the fintech sector through various channels. A more formal approach is through issuing reports. An example of this includes the AFM's and DNB's annual reports in which they discuss any developments in the financial markets that they have seen and their (future) supervisory response to these developments. Dutch regulatory authorities also have more informal approaches to addressing these developments. For example, the InnovationHub is an information desk of DNB, the AFM, and the ACM where fintechs can ask questions to these authorities regarding supervision and applicable regulations. Additionally, events like "Fintech meets the regulators" aim to bring fintechs and regulators together to discuss specific topics such as open finance and AI. These examples show the willingness of Dutch regulatory authorities to keep track with innovations and constantly adapt its regulatory approach to the (new) practical needs of the fintech sector.

Restrictions

As everywhere, the financial sector in the Netherlands is highly regulated. In practice this means that many fintechs require a licence or registration to be able to provide regulated services, unless they can rely on an exemption or exclusion. Often, regulated undertakings can "passport" their licence to other European jurisdictions, giving them access to the entire European market.

Fintechs that do not provide regulated services, may still be indirectly impacted by financial services legislation. For example, when their relationship with regulated financial undertakings is considered an outsourcing arrangement. In such case, the regulated undertaking will impose certain requirements on the fintech to comply with regulatory requirements.

Fintechs often work with large sets of (personal) data. Pursuant to the GDPR and the Schrems II ruling, all European companies must have certain safeguards in place, especially when transferring outside the EU. The GDPR is a reason for some data driven companies to keep their European activities separate from their operations elsewhere. Others simply apply the European regulations worldwide, as they are most stringent and therefore allow them to be complaint globally.

Dutch supervisory authorities have been watching the crypto sector. Recently, DNB has imposed fines on Binance and Coinbase for being active in the Netherlands without the required registration.

At the same time, Dutch supervisory authorities are in a constant dialogue with the financial sector. As a recent example in the field of payments, DNB took the position that payment institutions and electronic money institutions should perform sanction screening not only on merchants (i.e., the clients of the PSP), but also on shoppers at those merchants (i.e., the clients of their clients). This caused quite some turbulence in the market. After having consulted with the market, DNB ultimately announced not to enforce this requirement for the time being (awaiting public policy developments in this regard).

Dutch supervisory authorities are also collaborating with the industry to ensure workable regulations. For instance, the current implementation of AML requirements at banks poses a risk of system congestion. To address this issue, the DNB and the Dutch Banking Association are cooperating to establish a common ground on best practices.

Cross-border business

The European (financial) markets have a history of increased integrations following crises, such as the global financial crisis in 2007/2008 and Brexit. This has led to the further building of a capital markets and banking union. At the same time, other areas, such as fiscal laws, remain a national affair.

Many Dutch regulated financial undertakings, including fintechs, can rely on an EU "passport" that allow them to provide their services throughout the entire EU. This means that they have access to the largest economical region in the world, on the basis of a single licence.

The Dutch, and especially the Amsterdam fintech ecosystem, has grown significantly as a result of Brexit, due to the many companies that have moved HQs in order to continue servicing the European markets.

At the same time, national and regional fintech organisations, such as Holland Fintech are collaborating more and more with their counterparts in other European jurisdictions. This has resulted in a close network of European fintechs.

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