Call for evidence

Digital Finance

03 August 2021

Responding to this paper

ESMA invites comments on this paper and in particular on the specific questions summarised in Appendix 1. Responses are most helpful if they:

• respond to the question stated;

• contain a clear rationale;

• give concrete examples

ESMA will consider all responses received by **1 August 2021.**

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input - Consultations’.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA_QUESTION_DCFE_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA_DCFE_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_DCFE_ABCD_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website (www.esma.europa.eu under the heading “Your input – Open consultations” → “Call for Evidence on Digital Finance”).

Publication of responses

All contributions received will be published following the close of the call for evidence, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper

All interested stakeholders are invited to respond to this call for evidence.

This call for evidence is primarily of interest to:

(i) Financial firms relying on third-parties, in particular technology firms, to fulfil critical or important functions;

(ii) Third-parties, in particular technology firms, on which financial firms rely to fulfil critical or important functions;

(iii) Technology firms providing financial services, either directly or through partnerships with financial firms;

(iv) Platforms marketing or providing access to different financial services;

(v) Groups combining financial and non-financial activities, also known as mixed activity groups.

Abbreviations and definitions

Abbreviations

EBA	European Banking Authority
EC	European Commission
ESAs	European Supervisory Authorities
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
EU	European Union
ICT	Information and Communication Technology
MAGs	Mixed-activity groups
NCA	National Competent Authority

Definitions

'Financial firm' means any firm falling within ESMA's remit, including (i) alternative investment fund managers of 'AIFMs' as defined in Article 4(1)(b) of the AIFMD and depositaries as referred to in Article 21(3) of AIFMD ('depositaries of alternative investment funds (AIFs)'); (ii) management companies as defined in Article 2(1)(b) of the UCITS Directive ("UCITS management companies") and depositaries as defined in Article 2(1)(a) of UCITS Directive ("depositaries of UCITS"); (iii) central counterparties (CCPs) as defined in Article 2(1) of EMIR and Tier 2 third-country CCPs within the meaning of Article 25(2a) of EMIR which comply with the relevant EMIR requirements pursuant to Article 25(2b)(a) of EMIR; (iv) trade repositories as defined in Article 2(2) of EMIR and in Article 3(1) of SFTR; (v) investment firms as defined in Article 4(1)(1) of MiFID II and credit institutions as defined in Article 4(1)(27) of MiFID II, which carry out investment services and activities within the meaning of Article 4(1)(2) of MiFID II; (vi) data reporting services providers as defined in Article 4(1)(63) of MiFID II; (vii) market operators of trading venues within the meaning of Article 4(1)(24) of MiFID II; (viii) central securities depositories (CSDs) as defined in Article 2(1)(1) of CSDR; (ix) credit rating agencies as defined in Article 3(1)(b) of the CRA Regulation; (x) securitisation repositories as defined in

Article 2(23) of SECR; or (xi) administrators of critical benchmarks as defined in Article 3(1)(25) of the Benchmarks Regulation.

‘Financial service’ and ‘financial product’ means any financial service and product falling within ESMA’remit, i.e., any financial service and product provided by a financial firm as defined above. Please note that banking, payment, credit and insurance services and products are excluded from the scope of the call for evidence as they fall within EBA’s and EIOPA’s remit.

‘Platform’ means any digital platform that enables financial firms directly (or indirectly using a regulated or unregulated intermediary) to market to investors, and/or conclude with investors contracts for, financial products and services. The definition of ‘platform’ aims to be both ‘model’ and ‘technology-neutral’. Examples of platforms that are relevant for this call for evidence include but are not limited to technical infrastructures used by financial firms to market or distribute different financial products and services, and enabling investors to access products and services provided by different financial firms, such as fund distribution platforms, robo-advisors and on-line trading platforms. Those technical infrastructures that have been developed by financial firms for their sole individual benefit are outside of the scope of this call for evidence.

‘Mixed activity group’ means a group of undertakings (a parent undertaking and its subsidiary undertakings) conducting both financial and non-financial activities.

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1 Executive Summary

Reasons for publication

Technological innovation is transforming financial services at an unprecedent speed, by facilitating new business models and services and the entrance of new market participants. Covid-19 is accelerating this shift and the digitalisation of financial services. These changes bring a host of opportunities, including the prospect of better financial services for businesses and consumers and greater financial inclusion. Yet, they raise challenges as well, as they can contribute to introduce or exacerbate new risks. Also, the existing regulatory and supervisory framework may not fully capture and address these new developments.

In September 2020, the European Commission (EC) published a digital finance package[1] with the aim to embrace digital finance in the EU. Following on the package, in February 2021, the EC set out a request for technical advice[2] to the European Supervisory Authorities (ESAs) on three main issues, namely (i) the growing fragmentation of value chains in finance, (ii) digital platforms and (iii) groups combining financial and non-financial activities. In particular, the ESAs are requested to assess the regulatory and supervisory challenges brought by these developments and the way in which they could be addressed. ESMA is seeking feedback from external stakeholders to inform its work on the matter.

Contents

Section 2 explains the background of this call for evidence. Sections 3, 4 and 5 set out the topics on which ESMA is asking for feedback and the questions. Appendix 1 summarises the questions.

Next Steps

ESMA will consider the information received through this call for evidence when drafting its response to the EC. ESMA, together with the other ESAs, need to deliver a report to the EC by 31 January 2022. The technical advice received from the ESAs will not prejudge the EC's decisions in any way.

[1] Digital finance package | European Commission (europa.eu)

[2] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/210202-call-advice-esas-digital-finance_en.pdf

2 Introduction

1. Digitalisation is transforming society, the economy and the financial sector. This transformation, and the application of innovative technologies in the EU financial sector, has the potential to benefit people and companies. By facilitating the entry of new market participants, reducing geographical barriers and promoting greater transparency in the provision of financial services, technological innovation can provide better financial services to a wider range of businesses and consumers, possibly at a lower cost. It can also foster financial inclusion.

2. Meanwhile, those changes are not exempt of challenges. The entry of - large and small - technology companies in financial services and the growing reliance on those companies by financial firms can give rise to new forms of risks, e.g., in relation to security, interconnectedness, concentration and competition.[3] These changes raise specific regulatory and supervisory challenges as well, including due to their global and cross-sectoral nature and the risk of unlevel playing field.

3. The EC aims to address the challenges and risks attached to digital transformation by proposing, where relevant, adaptations to the existing legislative frameworks by mid-2022. To prepare these actions, and considering that regulation should be technology neutral according to the 'same activity, same risk, same rule' principle, the EC is requesting technical advice from the ESAs on the following key issues[4]:

    a. more fragmented or non-integrated value chains arising as a result of the growing reliance by financial firms on third parties for the delivery of their services and the entry of technology companies in financial services;

    b. platforms and bundling various financial services;

    c. groups combining different activities, namely mixed activity groups providing both financial and non-financial services.

4. Importantly, the recent legislative proposals for the Digital Markets Act (DMA)[5] – adopted on 15 December 2020 – and Digital Operational Resilience Regulation (DORA)[6] intend to

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[3] For a detailed introduction on how BigTech firms are entering the financial services sector and the possible challenges and benefits associated with this development, please have a look at ESMA's 'Trends, Risks and Vulnerabilities report 1/2020'.

[4] The EC is also asking EBA for input in the areas of protection of client funds and non-bank lending.

[5] https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital-markets_en

[6] https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en

address some of the above risks and challenges already. DMA proposes new ex-ante rules for gatekeeper platforms as well as a new supervisory framework at EU level to address conduct and competition harm risks. Most of the large technology companies which are currently offering financial services are likely to fall into the scope of this proposal. Similarly, DORA proposes a new oversight framework for those ICT service providers that are critical to the financial sector, which is likely to apply to most of the large technology companies to the extent that they provide ICT services to financial firms. The framework aims to monitor and address concentration risk and systemic risk that may arise from critical third-party provision of ICT services. However, other gaps and issues, e.g., in relation to conduct or prudential risks or cooperation between relevant competent authorities, may be left unaddressed and require further adaptations to the existing regulatory and supervisory frameworks.

5. With this call for evidence (CfE) ESMA seeks the input of market participants, technology companies and other stakeholders on those remaining gaps and issues that would need to be addressed.

6. Noteworthy, ESMA is cooperating closely with EBA and EIOPA on these matters, leveraging on the work already undertaken, for example in the form of a survey on digital platforms to the industry[7] for what concerns EBA or a Discussion Paper on the (re)insurance value chain and new business models arising from digitalization[8] for what concerns EIOPA.

[7] https://www.eba.europa.eu/financial-innovation-and-fintech/fintech-knowledge-hub/regtech-industry-survey

[8] EIOPA (2020). Discussion Paper on the (re)insurance value chain and new business models arising from digitalization.

General information about respondent

Name of the company / organisation	BVI
Activity	Asset Manager Association
Are you representing an association?	☒
Country/Region	Germany

Q1 Please insert here any general observations or comments that you would like to make on this call for evidence, including how relevant digital finance may be to your own activities.

<ESMA_QUESTION_DCFE_1>

Digital technologies have the potential to bring about a massive upheaval in the financial sector over the next few years, even though asset management is already a largely digitised industry. Asset management will be significantly influenced by improved availability of data, algorithms, digitalisation of assets, new processes in custody and settlement, and reporting. Quality data is a prerequisite for the provision of any service along the entire value chain in asset management, from research, portfolio and risk management, trading to clearing and settlement. Secure access to and availability of high-quality financial market data at all times is also indispensable in fund distribution or in regulatory and customer reporting. In the future, more and more non-traditional data sources (BDAI "big data & artificial intelligence") (“blockchain” /”DLT”) will be integrated into the asset managers' day to day business operations.

Financial market data are often offered by natural monopolies and oligopolies such as stock exchanges and companies with a dominant market position. These have great market power and can set one-sided conditions, since the users on the asset manager side rely on such data and any disruption would jeopardise their business. The use of financial market data has therefore for years been associated with regular, sometimes massive price increases and the conclusion of increasingly complex data licences for the asset managers. With increasing cost pressure and the change of business models to more quantitative or passive investment, data costs are becoming more and more a success factor for many asset managers. The BVI advocates a revision of the existing EU regulations for the provision and use of financial market data on appropriate commercial terms, e.g. in MiFID/MiFIR, CRAR, and an implementation of data user effectively protective regulations, e.g. in the BMR and the various EU regulations on regulatory reporting. Data charges should be determined on the basis of the marginal cost of producing and disseminating the data. Also basic data elements required for use EU regulatory reporting such as market price (MIFIR/SFTR), index (BMR), ratings, (CRAR) identifiers / reference data and ESG data (CSRD, EU-Taxonomy, SFDR, ESAP) should be made available in license and fee free databases such as the European Rating Platform (ERP) operated by ESMA. The EU Commission announced recently plans for a European Consolidated Tape on bond and equity prices as well as the European Single Access Point for financial and non-financial corporate data. Additionally, expanding the ESMA Benchmark register to full European index database would be most helpful to the users of such regulatory required data. To allow users to access the regulatory required data both from EU open data bases as described as well as directly on the websites of the respective data sources implementing regulation needs to provide for the respective EU bodies to set standardized terms of use of such data and databases, including the right to unencumbered and perpetual internal use.as well as liability for the correctness of the data. The EU Database regulation needs to be limited in its scope as it prevents the use of open EU databases contributed private sector data as demonstrated by the usage restrictions imposed by the CRAs on the European Rating Platform operated by ESMA

Our members also use cloud providers along the entire value chain within the asset management industry (e.g. research, trading).

On a separate note, EU law should at least provide for some minimum of harmonisation of contract and securities laws to facilitate the issuance of digital financial instruments by, inter alia, prohibiting paper-based financial instrument requirements or physical registration requirements with, e.g., a notary public or land registers in the medium term to allow for fully digitalised value chains. Germany, for example, still largely requires paper-based securities issuance.

<ESMA_QUESTION_DCFE_1>

3 More fragmented or non-integrated value chains

7. Technological developments are increasing the extent to and ways by which financial firms rely on third-parties, in particular technology firms, for the delivery of services, thereby leading to more fragmented or non-integrated value chains. This dependency can take different forms, e.g., outsourcing, partnerships, cooperation agreements or joint ventures. Examples include cloud outsourcing arrangements or the use of technology companies for data analytics, risk management or marketing purposes. In addition, digital innovation facilitates the entry of technology companies in financial services, again leading to potentially closer interlinks and increased inter-dependency between those companies and financial firms.

8. These new business models may entail various benefits, such as increased efficiency. However, they may also introduce new risks and may not be fully captured by the existing regulatory framework. Indeed, the entities contributing to the provision of the financial services may be subject to a set of individual requirements in the absence of a holistic approach or even fall outside of the regulated space. These models may also raise challenges in relation to cross-border supervision, cooperation between different competent authorities, as well as legal responsibility for conduct, operational resilience of the entire value chain and prudential treatment.

9. This call for evidence aims to collect evidence on new material developments in the evolution and fragmentation of value chains and the extent to which this phenomenon introduces new risks and/or create regulatory and supervisory challenges.

Questions

Q2 Do you observe changes in value chains for financial services (e.g., more fragmented value chains) as a result of technological innovation or the entry of technology firms? How different is the situation now when compared to pre-Covid?

<ESMA_QUESTION_DCFE_2>

From an investment fund industry perspective, our members will in the medium term invest also more in crypto assets depending on the extent that the regulatory framework for AIF/UCITS funds allows investments in crypto assets. Market penetration will depend a lot on whether crypto assets only exist in parallel to traditional assets or whether they will (partially start to) replace traditional (paper-based) assets, such as shares. Our interest is more on those crypto assets that represent traditional underlyings in financial instruments (bonds, shares) and real estate currently allowed for most regulated funds rather than non-traditional investment opportunities such as Bitcoin. Furthermore, as mentioned in our response to Q1, quality data is a prerequisite for the provision of any service along the entire value chain in asset management.

We did not observe significant changes in value chains resulting from the COVID-19 crisis. In some instances, it has led to projects which had been in pipeline already to being brought forward earlier.
<ESMA_QUESTION_DCFE_2>

Q3 Do you consider that financial firms are increasingly relying on technology firms to fulfil critical or important functions? If so, for which particular functions? Are there particular types of technologies (e.g., BigData, artificial intelligence, cloud computing, others) and technology firms involved?

<ESMA_QUESTION_DCFE_3>

The use of big data (BDAI), artificial intelligence (AI) and machine learning (ML) in asset management bears great potential. An increasing degree of automation of processes and interfaces has been common practice in the asset management industry for decades and is described with the keywords 'business process automation' (BPA) or 'robotic process automation' (RPA). RPA aims to automate even more complex process steps along the value chain in the asset management industry. An example of this would be a standardised online client check and initial advice in the securities business, possibly using language programmes. The use of AI is a major issue in the financial sector, as these technologies will bring about a profound change in society and the economy. AI goes beyond BPA and RPA by combining the use of large or increasingly available, but often unstructured and internal and/or external data sets with the improved possibilities for using these data. Through a combination of analytics and mass available data, new insights are to be gained that would not be possible with traditional research methods. The German supervisory authority BaFin was one of the first supervisors to analyse the challenges and implications for supervision and regulation of financial services in its report 'Big Data meets artificial intelligence'. BaFin concludes that big data and AI bring about a profound change and enable innovation, successful implementations can spread rapidly, and supervision and regulation must address innovative developments early. The report already highlights supervisory and regulatory implications. Cloud computing in the sense of focusing public clouds is to a certain extend restricted by overly administrative regulation on outsourcing of IT services, including but not limited to the requirement of audits on the cloud provider. Beyond the blockchain technology (usually based on Ethereum) becomes more important going forward as a means to distribute and share data immediately to all parties involved in a transaction.

BVI is particular supportive of exploring the use of blockchain technology in fund units (AIF/UCITS) processing as well as facilitating other investment processes, in particular in asset classes which are currently not fully digitalized such as promissory notes and loans (Schuldscheindarlehen) or collateral management.

<ESMA_QUESTION_DCFE_3>

Q4 Do you have examples of technology companies providing financial services in the EU, either directly or through arrangements with financial firms? If so, please briefly describe their business model and the type of financial services that they provide.

<ESMA_QUESTION_DCFE_4>

This question is very broad as there are examples across the full value chain of asset management from trading to middle and back office functions in which technology companies provide financial services in the EU, either directly or through (outsourcing) arrangements with financial firms. One issue which comes to mind is the provision of order management (OMS) and execution management bond, derivatives, and equity trading systems (EMS) which may effectively replace regulated multilateral trading systems (MTF/OTF) under MiFIR. The delineation between OMS/EMS and MTF/OTF was therefore consulted by ESMA recently.

<ESMA_QUESTION_DCFE_4>

Q5 Do you have examples of technology companies being used by financial institutions in the EU to fulfil critical or important functions? If so, please briefly describe their business model and the way in which they contribute to, or facilitate, these critical or important functions.

<ESMA_QUESTION_DCFE_5>

Please see our answer to Question 4.

<ESMA_QUESTION_DCFE_5>

Q6 Do you see changes in the way or extent to which financial market data are being collected, used and disseminated by unregulated data service providers?

<ESMA_QUESTION_DCFE_6>

Financial market data are often provided by regulated data entities as well as market data distributors (MDD) who collect, catalogue and distribute such data. However, some MDDs – such as Bloomberg, Moody's, Refinitiv, or Six Financial – are not regulated as financial services providers. Such cases are relevant in the area credit ratings provided by CRAs. Such situation was confirmed by ESMA in a report published in 2019 on fees charged by Credit rating Agencies where ESMA mentioned that CRAs distribute credit rating to subscribers through information services companies that are not regulated. Therefore, given the concerns that such practices would raise from an investor protection perspective, ESMA is of the view that CRAs should be clearly responsible for the distribution of the credit ratings they produce

Many data sources and MDDs profit since the global financial crisis from regulatory demand creation for data and take advantage of their dominant positions that they have created to dictate their price and conditions. Backed by supervisory laws and regulations, these monopolies and dominant players (for instance, regulated markets ("exchanges"), benchmark (index) administrators, credit rating agencies) jeopardize the functioning of the financial services industry by adding layer upon layer of data licenses on users required by law to use e.g. ISINs and other regulated data fields which take on a dimension of "public goods" in EMIR, MIFIR, SFTR, transaction or AIFMD, UCITS and CRR/Solvency 2 reporting in Europe, as well as e.g. in the USA.

Therefore, a coherent regulatory scheme should not only encompass the regulated financial market data providers, such as exchanges, but also their unregulated group financial market data companies, e.g. SIX Financial, LSE-Refinitiv, Deutsche Börse/Quantigo, ICE-Data, and index companies belonging to exchange groups such as FTSE or STOXX, as well as other dominant data sources and MDDs, such as Bloomberg, Factset, or locally WM-Daten which are important for the proper functioning of the markets and ultimately financial stability.

Quality data is a prerequisite for the provision of any service along the entire value chain in asset management, from research, portfolio and risk management, trading to clearing and settlement. Secure access to and availability of high-quality financial market data at all times is also indispensable in fund distribution or in regulatory and customer reporting. In the future, more and more non-traditional data sources ("big data") will be integrated into the asset managers' business operations.

Financial market data are often offered by natural monopolies and oligopolies such as stock exchanges and companies with a dominant market position. These have great market power and can set one-sided conditions, since the users on the asset manager side rely on such data and any disruption would jeopardise their business. The use of financial market data has therefore for years been associated with regular, sometimes massive price increases and the conclusion of increasingly complex data licences for the asset managers. This finding is corroborated by ESMA. In some cases, the price increases have reached 400% since 2017, as highlighted by ESMA. The increased cost of data, resulting from a combination of changes in Pricing Policies and Data Licence Polices by data sources such as Regulated Markets, CRAs and Benchmark Administrators as well as unregulated market data distributors (MDD) and compounded by the recent extension of reporting requirements imposed by several legislations, is forcing asset managers to scale back data purchases by 40% to 50% for certain strategies. This leads to less information being available to the fund managers and the need to buy specific research information. These increased costs negatively affect the net performance of investment funds and, by way of consequence, the return to investors. We witnessed that financial services fintech innovation was made difficult by dominant data sources. For example, a start-up wanting to analyse the stability of credit ratings with the help of artificial data was nearly prevented from making the respective offer by expensive credit rating data licences which would have prevented the intended product set-up.

With increasing cost pressure and the change of business models to more quantitative or passive investment, data costs are becoming more and more a success factor for the asset management industry. BVI advocates a revision of existing EU regulation for the provision and use of financial market data on appropriate commercial terms, e.g. in MiFID/MiFIR, CRA Regulation, and an implementation of data user effectively protective regulations, e.g. in the BMR and the various EU regulations on regulatory reporting. Data charges should be determined on the basis of the marginal cost of producing and disseminating the data.

Against this background, it must be ensured that access to data is not unduly restricted and is provided in a reasonable and transparent manner.

<ESMA_QUESTION_DCFE_6>

Q7 What implications, if any, do changes in value chains (e.g., more fragmented value chains) have on your own activities? To which extent are you taking an active role in these changes?

<ESMA_QUESTION_DCFE_7>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_7>

Q8 Do you see new or exacerbated risks (e.g., to investor protection, financial stability, market integrity, security or level playing field) in relation to the reliance on technology firms by financial firms?

<ESMA_QUESTION_DCFE_8>

There is a risk that the usual assessment of services provided via new technologies or through new technology firms do not necessarily fit anymore. This also pertains to non-traditional trading platforms such as crypto-asset exchanges. Consequently, this might require adaptations to the respective due diligence and assessment practices to ensure proper assessments.

In general, there could be areas of potential risks and harms in relation to the development, testing and deployment of AI and ML such as governance and oversight, algorithm development, testing and ongoing monitoring, data quality and bias, transparency and explainability, and ethical concerns. However, it is also important to highlight that AI and ML also enable innovation and can make contributions along the entire value chain. The circumstances how firms are using AI and ML techniques (such as advisory and support services, risk management, client identification and monitoring, selection of trading algorithms) already show the high impact on the industry. These techniques will also benefit clients in the medium term, particularly in investment advice and client service. AI can, for example, put together tailor-made portfolios depending on the investment objective and horizon, or directly answer repetitive questions from clients in order to provide better services.

Moreover, outsourcing practises as such should not be understood as a potential risk as long as there are objective reasons for delegation (such as optimising of business functions and processes, cost saving, expertise of the delegate in specific markets or access of the delegate to global trading capabilities) and proper and efficient outsourcing processes are in place in understanding the dependency and relationship with the third-party provider (such as due diligence assessments, ongoing outsourcing controlling, necessary expertise and resources to supervise the delegated tasks effectively and manage the challenges associated with the delegation).

<ESMA_QUESTION_DCFE_8>

Q9 Do you see new or exacerbated risks (e.g., to investor protection, financial stability, market integrity, security or level playing field) in relation to the provision of financial services by technology companies?

<ESMA_QUESTION_DCFE_9>

No - please see our response to question 8.

<ESMA_QUESTION_DCFE_9>

Q10 Do you see new or exacerbated risks (e.g., to investor protection, financial stability, market integrity, security or level playing field) in relation to the collection, use and dissemination of financial market data by unregulated data service providers?

<ESMA_QUESTION_DCFE_10>

In particular, there are risks to the well function and transparency of markets if regulated and unregulated data sources and data distributors can block data access by regulated financial market firms to especially to data which use is required by EU regulation should be a focus on all data sources delivering data which use is required in regulation, including but not limited to trading venues (prices), index providers ,CRA rating data feeds, reference and identifier data providers such as ANNA member S&P CUSIP Global Services, and going forward providers of alternative, especially ESG data (as required by SFDR, CSRD, EU Taxonomy) in order to discourage anti-competitive behaviour. Competent authorities should therefore be enabled by primary or secondary regulation to monitor all regulated and unregulated group companies and insure they adherence to EU rules.

Without secure access to the data and ICT services, operational resilience of financial services in general and in specific cases also financial stability is at risk. The importance of technical errors at exchanges as ICT providers can be seen by looking at Deutsche Börse Group. In 2020, two exchange outages disrupted equity and derivative trading for several hours at the Frankfurt venue. The Vienna, Prague, Budapest, Zagreb, Ljubljana, Sofia including all types of intentional or non-intentional events, with these providers, including contractual disputes, which may lead to interruption of ICT services. Valleta exchanges went down as well, all of which use the Deutsche Börse trading system. On the non-technical error side e.g. in 2016 S&P ordered a data cut-off in the Bloomberg TOMS system at two banks in Europe which interrupted their trading operations without proper warning. Luckily, a flash crash in the market was avoided at the time when the banks trades could not be completed.

<ESMA_QUESTION_DCFE_10>

Q11 Do you consider that some adaptations to the EU regulatory framework are needed to address the risks brought by changes in value chains?

<ESMA_QUESTION_DCFE_11>

In general, standardisation and common rules on a broader set of features and technical aspects are needed for the different systems to interact smoothly with each other. It is therefore necessary that any new regulatory framework should be able to be interoperable on a technical basis.

<ESMA_QUESTION_DCFE_11>

Q12 Do you consider that some adaptations to the EU regulatory framework are needed to unlock the benefits brought by changes in value chains?

<ESMA_QUESTION_DCFE_12>

One of the major hurdles regarding a potential application of blockchain technology concerns the lack of industry standards. Private blockchains (i.e. blockchains that are only used within a company) can be useful for internal applications. The elaboration and implementation of DLT standards would create interoperability between different blockchain systems and allow parties to work directly with each other without the use of interfaces and middleware. So far, the market has not been able to agree on common industry standards for interoperability. To encourage development at this level, standardisation initiatives should be supported. Therefore, we recommend the development of a strategy at European level to support blockchain standardisation work. The European Commission established an observatory and a forum on blockchain technology in early 2018 to monitor the development of the technology and promote cooperation between relevant stakeholders. Standardisation should become an elementary part of the work.

<ESMA_QUESTION_DCFE_12>

Q13 Do you consider that there is a need to enhance supervisory practices, e.g., cross-border or cross-sectoral cooperation, in relation to changes in value chains?

<ESMA_QUESTION_DCFE_13>

Yes, in the area of regulatory reporting. ESMA and the EU Commission attempts to address the jungle of different data standards and formats in the regulatory reporting system which represent an enormous burden for the asset management industry and the competent authorities, both operationally and financially. Each National Competent Authority or national central bank requires to obtain identical regulatory fund and transaction data in different ways: different extents, at different intervals, in different formats, on the basis of share classes or individual funds. The reason for such different requirements is the increased complexity in regulatory reporting since the financial market crisis, which has not been coordinated by the supervisory authorities and central banks. It also hampers efficient supervision in the analysis of systemic risks in financial markets. There is therefore an urgent need to reduce the current excessive reporting obligations and administrative burdens on fund companies (UCITS/AIFs) to a reasonable level. Similar issues arise with other regulated financial market participants, namely credit institutions, insurers and investment firms (IFD).

The key obstacle improving data collection is that different supervisory reporting requirements are already in place with detailed regulation also on Level 2 and Level 3. New and non-harmonized regulatory reporting schemes are currently developed (such as revised regulatory reporting under MiFIR, AIFMD, EMIR). Moreover, many reporting requirements differ between EU member states (MS) or are not obligatory in all MS. There is a need to change the current reporting requirements fundamentally to achieve such a long-term vision. Reform should not be limited to sectoral reporting requirements only, e.g. requirements applicable only to asset managers, banks or insurance undertakings. The reporting requirements are interconnected between these sectors because supervised entities such as banks or insurance companies (e.g. regulated through Solvency 2) often invest also in investment funds. Both CRR and Solvency II directives require banks and insurance undertakings which invest in investment funds to look through into the risk s and assets of the investment funds for the purposes of their own capital requirements and internal risk assessments. These Directives require delivery of data and further support services by investment fund management companies about risks assessments and asset data of investment funds in completely different ways and which are also not consistent with the reports which must be provided by the assets managers to their own authorities. Therefore, there is a need for a cross sector standardized data exchange in order to understand and report the risks of investment funds in the same way, irrespective of who is invested in the investment fund. In this context, BVI has produced a video illustrating the issue with proposed solutions (https://www.bvi.de/positionen/meldewesen/). The video is currently only available in German language. See also. https://www.bvi.de/fileadmin/user_upload/positionen/2018_03_14_BVI_Position_public_consultation_on_fitness_check_on_supervisory_reporting.pdf

<ESMA_QUESTION_DCFE_13>

Q14 Which recommendations, if any, would you make to EU regulators/supervisors to address opportunities and challenges brought by changes in value chains?

<ESMA_QUESTION_DCFE_14>

Please see our answer to Q13 in respect to reporting.

<ESMA_QUESTION_DCFE_14>

Q15 Do you have any other observations or comments in relation to changes in value chains?

<ESMA_QUESTION_DCFE_15>

Please see our comments to Q13.

<ESMA_QUESTION_DCFE_15>

4 Platforms and bundling of various financial services

10. Platforms can market and provide access to multiple different financial services, often from different financial firms. Different financial firms can also partner with technology firms to bundle a range of financial services which are then distributed through digital channels.

11. The financial firms and platform providers are not always part of the same group and sometimes operate in different EU Member States or third countries. In addition, the different financial services bundled on the platform may fall under separate sectorial regulations or outside of the scope of the EU financial services regulatory perimeter, which can leave certain risks unaddressed and raise specific supervisory challenges.

12. A more holistic approach to the regulation and supervision of these platforms and bundled services could be relevant, considering the increased risk that they can pose, regarding e.g. interaction with consumers and consumer protection, conduct of business, money laundering and operational risk.

13. The CfE is intended to help ESMA collect insights on the use of digital platforms in the EU the extent to which this phenomenon introduces new risks and/or create regulatory and supervisory challenges.

Questions

Q16 Do you have examples of platforms bundling different financial services from different financial firms in the EU? If so, please provide a brief description of the most prominent ones.

<ESMA_QUESTION_DCFE_16>

As the definition of platforms can comprise different types of services, the following responses refer to fund distribution platforms.

<ESMA_QUESTION_DCFE_16>

Q17 Do you consider that the use of platforms by financial firms for the marketing or the conclusion with customers of financial products and services is widespread in the EU? Do you observe an increase in the use of platforms compared to pre-Covid?

<ESMA_QUESTION_DCFE_17>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_17>

Q18 (To financial firms) As a financial firm, are you using platforms for the marketing or the conclusion with customers of your financial products and services? If yes, please provide a brief description of(i) the types of services provided by the platform, (ii) the arrangement in place with the platform (e.g., are you or the platform responsible for the governance and/or maintenance of the technical infrastructure and the interactions with customers), (iii) the extent and way in which the arrangement is disclosed to the customer, (iv) the tools and processes in place to ensure that the risks attached to the financial products and services are properly disclosed to the customers.

<ESMA_QUESTION_DCFE_18>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_18>

Q19 (Same question to platforms) As a platform, do you facilitate the marketing or the conclusion with customers of financial products and services? If yes, please provide a brief description of(i) the types of services provided to financial firms, (ii) the arrangement in place with the financial firms (e.g., are you or the financial firm responsible for the governance and/or maintenance of the technical infrastructure and interactions with customers), (iii) the extent and way in which the arrangement is disclosed to the customer, (iv) the tools and processes in place to ensure that the risks attached to the financial products and services are properly disclosed to the customers.

<ESMA_QUESTION_DCFE_19>

Not applicable

<ESMA_QUESTION_DCFE_19>

Q20 Which key opportunities and challenges do you see in relation to the use of platforms by financial firms?

<ESMA_QUESTION_DCFE_20>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_20>

Q21 Do you consider any of the following risks to be new/exacerbated where financial firms use platforms for the marketing or conclusion with customers of contracts for financial products and services? Please explain(i) risk to financial stability, (ii) risk to investor protection, (iii) risks in relation to conduct of

business, (iv) ICT and security risks, (v) money laundering / terrorism financing, (vi) risk to data protection and privacy, (vii) risk to fair competition, (viii) market manipulation, or (ix) other risks.

<ESMA_QUESTION_DCFE_21>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_21>

Q22 (For financial firms) Which controls, and processes are in place to oversee the specific risks emerging from the use of platforms?

<ESMA_QUESTION_DCFE_22>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_22>

Q23 Do you consider that some adaptations to the EU regulatory framework are needed to address the risks brought by the use of platforms?

<ESMA_QUESTION_DCFE_23>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_23>

Q24 Do you consider that some adaptations to the EU regulatory framework are needed to unlock the benefits brought by the use of platforms?

<ESMA_QUESTION_DCFE_24>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_24>

Q25 Does the use of platforms give rise to any challenges regarding the cross-border supervision of financial sector activities in the EU? Do you consider that there is a need to enhance supervisory practices, including convergence measures, in relation to the use of platforms?

<ESMA_QUESTION_DCFE_25>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_25>

Q26 Which recommendations, if any, would you make to regulators/supervisors to address opportunities and challenges brought by the use of platforms?

<ESMA_QUESTION_DCFE_26>

As we have already seen with payment services, the large platforms (BigTech) have the technical and operational capabilities to provide financial services. The case of the Diem shows that a product described in the media as a payment instrument can certainly also fall into the category of an investment product. Depending on the final specifications of a Libra token, it could qualify as a share of a money market fund und thus be subject to investment funds regulation. Alibaba-owned Yu'e Bao, one of Chinas largest money market funds, is another example of a BigTech company providing asset management services.

The case of the Diem is an also example of how BigTech through platform economy has the capability to form an investment product with potentially enormous market capitalisation that raises questions regarding the concentration and market stability.

Against this background, we recommend conducting further analysis of platforms providing financial services. This pertains not only issues related to concentration and market stability, but also overall market power and pricing models.

<ESMA_QUESTION_DCFE_26>

5 Risks of groups combining different activities

14. Large technology companies active in various sectors and forming mixed-activity groups increasingly enter the financial services sector, including through the establishement of their own subsidiaries for the provision of financial services. These groups can quickly scale up the offerings in financial services leveraging on vast amounts of customers' data collected through their affiliated entities and elevating intra-group dependencies on operating systems and processes. The capacity to use intra-group data and other processes within the group to support the provision of financial services raises challenges in relation to conduct, prudential and systemic risks and a possible detrimental effect to the level playing field between entities providing the same financial services as a part of a group versus a single entity.

15. Even though existing sectoral financial legislation already embeds approaches for group supervision, it does not provide a framework for coordinated supervision on a cross-sectoral basis for emerging types of mixed activity groups, as their financial activities usually represent only a limited share of their total balance sheet. Even when a group has a specialised financial subsidiary undertaking within its group, sectoral financial legislation would only apply to that subsidiary undertaking, with limited possibilities to supervise and prevent risks stemming from the interactions between the financial subsidiaries and the broader group.

16. The new emerging risks in relation to mixed-activity groups that build up substantial market share in financial services may not be captured by the existing EU legislation and by supervisory practices limited to regulated entities in the mixed-activity groups.

17. The call for evidence aims to collect evidence on whether (i) large technology companies as mixed-activity groups should be supervised specifically, (ii) how interdependencies withing the groups, and potential risks stemming from, can be identified and adressed, and (iii) how supervisory cooperation can be improved for these groups.

Questions

Q27 Are you aware of mixed activity groups (MAGs), including BigTech groups, whose core business is not financial services but that have subsidiary undertakings that provide financial services in the EU?

<ESMA_QUESTION_DCFE_27>

We are aware of mixed activity groups (MAGs), whose core business is not asset management (data) services but that have subsidiary undertakings that provide asset management.

<ESMA_QUESTION_DCFE_27>

Q28 Which types of financial services do these entities provide?

<ESMA_QUESTION_DCFE_28>

We are aware of mixed activity groups (MAGs), whose core business is not asset management (data) services but that have subsidiary undertakings that provide asset management (individual portfolio management and advice under MiFID or investment funds (AIF, UCITS) in the EU. Usually with a focus on the management of group or stakeholder assets.

<ESMA_QUESTION_DCFE_28>

Q29 In such MAGs, how and to what extent the dependency of a subsidiary financial firm on its parent company and/or other subsidiaries of the same group influences the provision of the financial service?

<ESMA_QUESTION_DCFE_29>

The regulated subsidiary is managed as a standalone unit following the regulatory and supervisory demand. TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_29>

Q30 Do you see new or exacerbated risks in relation to MAGs?

<ESMA_QUESTION_DCFE_30>

No.

<ESMA_QUESTION_DCFE_30>

Q31 Do you consider that there is a risk of unlevel playing field between individual ('solo') financial firms and MAGs?

<ESMA_QUESTION_DCFE_31>

No - Usually asset managers within MAGs focus on the management of group or stakeholder assets. TYPE YOUR TEXT HERE

<ESMA_QUESTION_DCFE_31>

Q32 In your opinion, is the current EU regulatory framework adequate for MAGs?

<ESMA_QUESTION_DCFE_32>

Yes.

<ESMA_QUESTION_DCFE_32>

Q33 Do you consider there is a need for new cooperation and coordination arrangements between financial supervisors and other authorities (data, competition, consumer protection, AML/CFT, cyber) within the EU and/or with 3rd countries in order to ensure effective supervision of MAGs?

<ESMA_QUESTION_DCFE_33>

Yes, coordination and information exchange, especially also with tax authorities is required.

<ESMA_QUESTION_DCFE_33>