European Securities and Markets Authority

# Call for evidence

**Digital Finance**

16 September 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

[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 | Association of the Luxembourg Fund Industry (ALFI) |
| Activity | Asset Manager Association |
| Are you representing an association? | ☒ |
| Country/Region | Luxembourg |

**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>

Given the increased need of specialist knowledge to offer state of the art services in the financial sector, it is indeed correct that services may be outsourced and split amongst several service providers. As an example, from a stock exchange perspective, such collaboration with an increased number of service providers will not be visible to external counterparties (trading members, issuers, investors etc.) except through gains made in terms of efficiency or an extended service offer. The visible counterparty remains the stock exchange. The technological progress has therefore the positive effect of creating a more integrated but wider level of services without increasing the number of counterparties from a user's perspective. It is indeed correct that such collaborations may create additional counterparty risks, but given the existing legal and regulatory framework, these risks should in principle be well managed by the parties and supervised by the relevant NCA.

Financial market data has always been an important source of information for market participants. Given the possibilities new technologies offer, it is clear that the production and consumption of data is growing exponentially. Although the public availability of such data is key to ensure fair market conditions, one has to bear in mind that the production of reliable and high-quality datasets requires efforts that cannot be offered for free and by any new entrant in the market. It is therefore of utmost importance that a right balance is found between the availability of the data and its quality. It should be avoided that markets can be manipulated too easily by false or misleading information (be it intentional or by negligence).

Looking at the investment management industry that already relies to a large extend on service providers we could considered the value chain quite fragmented. The incumbent/traditional Investment Management service providers that are stakeholders of this value chain, such as transfer agents, fund administrators, depository banks, and so on, are regulated actors that comply to EU regulations of various nature. The possibilities offered by recent evolution of technologies in particular to digitalize interactions and operations, structure data points, streamline information exchanges and work with larger volumes of data enable new opportunities in the area of fund distribution, delegation oversight, portfolio management and monitoring, asset management and monitoring, or risk management, just to name a few domains that are impacted. They offer the potential to create new products and services, new distribution models, new business models, new operating models that could certainly generate efficiencies gains or transparency but also disrupt the way the whole industry is currently structured and safeguarded, posing threats in terms of investor protection, financial stability, information security, or resilience of the sector, etc.

Even if the pandemic has not dramatically changed the way the Investment Management industry work yet, it has likely contributed for the realization by the Fund Service Industry that investors and the financial markets are ready to adopt technology and digitalization. These new ways of doing are indeed possible and will generate benefits, provided the appropriate safeguards are in place notably in terms of cybersecurity and protection of data that is being unlocked through the digitalization enabled by new technologies.

Given the rapid progress made through new technologies, legislators and regulators should adapt their procedures and working habits in order to allow for quicker turnaround times. It goes without saying that the legislative evolution will never be totally synchronised with the pace at which technological progress is being made. A reflection should however be started on how to reduce the gap between a new technological milestone and the appearance of a definitive and reliable legislative or regulatory framework.

Technology is not a new phenomenon as the financial sector has been totally dependent on technology for the recording and settlement of transactions for over 50 years. Older financial sector infrastructure typically consisted of heavy, monolithic systems that were very robust, but were very difficult to change. The main goal when considering the use of Digital Finance are either to provide user friendly access to end used or customer, or to automate tasks requiring intensive manual workload using an external application that would require heavy development if developed in the mainframe.

The massively interconnected world requires the exchange of vast amounts of data between an exponentially increasing numbers of nodes. Modern technology, and the companies that provide this technology, provide one specific service on highly specialised systems, and connect with other tools and providers for other parts of the business logic. While the resulting fragmentation may incur risks (that can be managed through the application of the already applicable oversight duties by financial institutions) this approach offers major benefits in terms of maintenance, and adaptation to rapidly changing regulatory requirements.

Digital finance can be understood as new ways of financing or investing through the leverage of digital technologies. In a broader sense, the fund industry can use digital technologies to revisit the ways:

- Funds are distributed, enabling more direct distribution, through the use of DLT that have the potential to disrupt some actors in the value chain, or the leverage of platforms that could offer one “single point of shop” for investors.

- Lending or investments are made in a direct way, without intermediation, by peer-to-peer or decentralized platforms that enable for example, crowd-sourcing, peer-to-peer lending or asset tokenisation.

- Knowledge and insights on investors and their behaviour is collected and analysed for more targeted advices, cross selling or up-selling of additional products or services.

- Asset managers interact with their investors, or asset services interact with their clients, more remotely and in real time, with web-based or mobile device-based ordering or reporting that is more dynamic and provide look-through, slicing and dicing, etc.

- Management Companies perform their delegation using the so-called MancoTech that combine data collection and aggregation, KPI & dashboard production and functionalities to follow-up on service delivered by the delegate service providers.

- Various actors monitor and manage compliance with the use of so-called Regtech.

- Portfolio managers perform asset allocation and selection being assisted by robot advisor or follow up on risk and performance.

- Data is managed and governed, pooling ever-larger data sets and data points, and doing it with increased velocity.

- Back-office operations are processed, disrupting incumbents, enabling more Straight-Trough-Processing, or removing requirements for reconciliation.

<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>

For each of the impacted activities mentioned above, there are opportunities for new entrants, such as technology firms, or incumbents (i.e. financial services firms leveraging technological innovation) to develop specialized service offering that will target such niches. The consequence is that additional types of stakeholders will be part of the Investment Management value chain that will therefore become more fragmented. Some of those specialized services will naturally fall under exiting EU regulatory frameworks.

For the end-user, the value chain does not appear to be more fragmented. Quite the opposite, the new technology has enabled the aggregation of data from multiple sources into one simple portal or app for consumers, giving a more holistic feeling for investors.

Covid did not change much the situation, as it 'only' facilitated the possibility to work from home. Covid also did not lead to the deployment of new applications. Nonetheless, an evolution of the cyber threats and cyber-attacks has significantly increased during Covid and certain financial firms have been obliged to find structural responses, accelerating the adoption of new/more resilient technology-enabled financial services.<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>

Financial firms have been relying on technology for many years, and in the past were extremely dependent on just one core system provider that would be impossible to replace. This gave technology companies quite a dominant control over financial institutions, as replacement of such core systems was both financially and operationally impossible. In a more distributed architecture, financial firms have a much better ability to replace underperforming providers with better alternatives.

New areas that are being more and more impacted by new technology are, but not limited to:

- Management companies (MancoTech);
- Risk Management where pooling of large dataset is required;
- Compliance (RegTech);
- Investors/customers interactions and reporting (enabled by fintech on SaaS, or custom development by financial service firm on native cloud (Azure, AWS, Google, etc.);
- ESG reporting and ratings require additional data that that have to be computed (the sources from issuers need to be analysed and rated). So Funds, Asset Managers and Financial Service providers need to rely on external data, and on external systems, to run their 'Business As Usual';
- Electronic trading.

But, this could pose some risks, such as:

- Those solutions are quite nascent and might not yet have proven their effectiveness.
- Those solutions can implement complex algorithms and data transformation that might be black boxes that are difficult to comprehend – and validate – for some for their users.

- While those solutions bring some benefits they also come with their challenges and loopholes (example: video recognition versus deep fake).

<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>

The development of investment in tokenised assets require the use of a crypto-custodian, able to handle such assets in the DLT (Distributed Ledger Technology) environment. Most of the Credit Institutions cannot yet manage internally such assets, and rely on an external technology company to provide such Crypto Custody Services.

<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>

Cf. responses to Q3 and Q4.

<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>

The traditional financial market data focusses mainly on financial instruments and their usage thereof by consumers. Typical financial market data relate to payments, securities and their transactions, etc. Most technology have access however to much more deep data. As an example, a creditcard company would see a debit by a client for EUR 250 for a purchase on a shop run by a technology firm. But the technology firm knows what this EUR 250 was spent on, how long it took the consumer to decide on the purchase, what alternatives the consumer considered and so on, and of course what credit card was used to settle the transaction. The credit card firm only has that last bit of information. This access to vastly more granular data means that technology firms are much accurate in predicting customer behaviours than traditional financial firms because they move past the “settlement” and enter into the actual reality of the consumer.

Somehow linked to financial market data, the ESG indicators issued by specialised providers (which compute large amount of data to provide rating) might be produced by data providers that are not regulated.

Because software package providers are no providing their solutions in SaaS mode, they are seizing the opportunity to provide additional managed services. Some of them propose to manage part of the data on behalf on their clients (investment managers, funds managers, asset managers, asset servicers, etc.).

<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>

The trend in the industry is at least to adapt. The deployment of new technology (DLT imposes to Financial Institutions, funds, and management company, to consider them in their strategy, and use specialized service providers. But, the fragmentation is also an opportunity to develop new services, new communication channels, or enhancing operational efficiency.

The fragmentation of the value chain can be an important efficiency driver as long as a strong orchestration architecture is in place. Firms and their customers can benefit from best in breed solutions that operate together to improve customer experience. Investment Management actors are looking at externalizing even further their activities that are not core. For years, asset managers have developed target operating model considerations, which have resulted in the focus on core or value-adding activities.

The companies that lead with technological innovation typically follow a micro-service approach where highly specialised systems provide specific services and connect with other tools and providers to provide other parts of the business logic. While the resulting decentralised IT architecture may incur risks, this micro service approach offers major benefits. To name a few, small and dedicated micro services are easier to maintain and adapt to rapidly changing regulatory requirements. Due to their specialized nature, they also tend to do the specific function better than generic tools, their code is easier to audit and inspect, and the data flows are more transparent in a secure manner, which makes it easier to inspect how data is manipulated and exchanged. A final benefit is that micro services are easier to replace when they are outdated, or the required service levels are otherwise not met. This reduces the build-up of technical debt when large IT replacement projects are postponed due to their complexity and financial impact.

- One the one hand asset managers have gone through different outsourcing waves over the years, the first one regarded back-office activities, the second wave has broadly covered middle-office activities to finally move to a strategic partnership approach meaning focusing on truly core activities in which lies its specific competitive advantage. The third wave is the modular outsourcing of business processes on the entire Investment Management value chain, from front-office to middle-office and back-office. Technology and more specifically open-architecture is critical to this model, which will offer clients both proprietary and external products and services. This also give asset managers space to rethink the technology behind their core activities.

- On the other hand, for the same reasons, asset servicers also consider technology as a strategic advantage and acquire or invest in software solutions as a differentiating component of their platform offerings.

This approach results in the specialization of the different actors of the value chain is the emergence of new service providers such as Know Your Customer utilities, data management service providers, loan administrators, liquidity and treasury service providers, bank service aggregators, etc.

<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>

The use of new technology is a point to include in the Due Diligence process by Financial Institution, and at least to especially cover cyber risks (such as system interruption failure or cyber threats). The due diligences, risk assessment and management processes should also cover the new and continuously evolving technologies.

Financial firms have historically managed and even developed a lot of their technology internally, but internal development has proven to be slower and more expensive against important security threats. Cyber threats are increasing dramatically, not only due to the widespread use of technology by financial firms, but because of the massively availability of literacy with technology. This has created an increased number of hackers that look at every opportunity, and the major challenge for financial institution is to keep up with the speed of development of their adversaries.

<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>

There might be new and/or amplified risks that might occur due to the provision of financial services by technology companies. Some technologies companies might offer innovative services or products that are not covered by existing EU regulation framework and therefore might not follow the regulation and the industry best practices. In that case, they might indeed represent exacerbated risks.

The regulations in relation to these technology companies are key and if the financial services are provided by fully regulated and supervised technology companies, these risks might be mitigated.

<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>

New or exacerbated risks in relation to the collection, use and dissemination of financial market data by unregulated data service providers might occur. In case regulated financial service institutions use unregulated service providers, they need to be very cautious and consider all the related risks in their due diligence and ongoing monitoring. There is a need for continuously evolving risk assessment and management in relation to the new technologies.

The reliability of market data (for example, ESG data which may become very volatile depending on market conditions) is key, and safeguard should be implemented.

<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>

The DORA principles should prevail, and be well communicated. There is a risk not just of fragmented value chains, but also of fragmented regulation that is not understood, and therefore followed, by financial firms. In addition, with European countries, a harmonisation and simplification of the different regulatory requirements is key.

The regulations need to be reviewed and updated on a continuous basis as the pace and complexity of the new technologies is incremental.

<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>

A harmonisation on the regulatory guidance will be needed (as example, the divergence of classification of assets between several countries should be solved). The digital finance strategy package is generally welcome to provide a more harmonised cooperation.

<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>

TYPE YOUR TEXT HERE

<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>

Cf. above.

- The interoperability of systems (on Distributed Ledger Technology as an example) is needed.

- The supply of data regarding new investment that are not explicitly regulated (e.g. crypto-assets) shall be addressed by MiCA.

- Technology Platform, not regulated under European standards, should be explicitly highlighted. A service provider, based outside Europe (and not subject to European Regulation or supervision) brings additional risks to Retail of Financial Institutions.

- Distributed Ledger Technologies and tokenisation of assets may become very soon a game changer, providing a new set of assets to retail customers, without the safety net of the current financial regulation. This is why such investments from retail investors should only be performed via a financial institution or a regulated financial service provider

A large information on the benefit of the European regulations (MiCA, DORA, MiDLT) is needed to share widely the understanding of the risks and mitigations deployed by the European Commission to protect investors in Europe.

<ESMA_QUESTION_DCFE_14>

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

<ESMA_QUESTION_DCFE_15>

TYPE YOUR TEXT HERE

<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>

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<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>

The use of Distributors, such as AllFund, Vestima, FundChannel, was already widespread pre-Covid and we now see an increase of new companies, which provides access to tokenised assets. The growing use of these platforms is not so much related to Covid, but is a continuation of an earlier accelerating trend of disintermediation and customer-centric orientation of service models through technology.

<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>

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<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>

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<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>

Platforms can provide more flexibility, efficiency, and reduced time to market when developing new services. One distributor may distribute funds to a larger number of investors via the distribution network provided by the platforms. Other opportunities are identified in the development of automated process for Know Your Customers, or the compliance of a target market with the distributed products. Platforms that incorporate more in-depth intelligence about investors and their behaviours can offer a better fit of financial products to the wishes of financial consumers while making the suitability and appropriateness testing much more robust.

But a challenge may remain on the formalisation of the user understanding of the investment when a platform provides a single access to a broader range of products (with a potential formalisation of the control on suitability, and compliance with MIFID).

<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>

a) Risk to financial stability

No

b) Risk to investor protection

Yes, the formalisation of suitability tests when these ones are mandatory.

c) Risks in relation to conduct of business

No

d) ICT and security risks

Yes

e) Money laundering / Terrorism financing

Yes, there might be new risks that the institutions should consider when using platform (KYC, Origin of funds …), even if the technology may provide mitigation tools. This point is covered when entities are regulated.

f) Risk to data protection and privacy

Yes

g) Risk to fair competition

Yes, but this risk already existed before. The power over access to financial products is however shifting from distributors to technology companies. In the past, distributors had a lot of control over what products were presented to investors and which ones not. These decisions were sometimes unduly influenced by rebates and other financial incentives, which MIFID and other regulations have sought to address. When dealing with platforms, it is important that products are objectively and impartially presented, including the relevant information for investors to make sound investment decisions.

h) Market manipulation

Yes, the sources of information sources are wider than ever, with limited control on the veracity of the information, any fake news takes week to correct (removing the info, explaining why it is a fake news…) while investments are done within minutes.

i) Other

No

<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>

Standard Due diligence and oversight in place are to be enhanced on ICT risks. To better assess the outcomes of due diligence responses, boards and financial sector management teams need to be trained on technological matters, even if firms rely on third parties to assess IT security and other technical risks.

<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>

The EU regulatory framework could better address the risks emerging from the use of these platforms for mitigating those risks, by example, with the development of a new type of licence for company that are not yet regulated?

<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>

By mitigating the risks as mentioned above, this may result in unlocking certain benefits brought by the use of the platforms in a safer way.

<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>

See response to Q26, harmonisation is needed across European jurisdictions, in order to distribute funds cross border with the same rule across all countries.

<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>

- Harmonisation of cross-border and cross value chain regulatory rules;
- Whitelisting of authorised providers, or developing a new licence, to facilitate investor protection;
- Information/training of investors, to easily identify regulated versus unregulated distributor (logo on the website?) so retail would choose a service provider they can sue in Europe in case of issue;

<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>

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<ESMA_QUESTION_DCFE_27>

**Q28 Which types of financial services do these entities provide?**

<ESMA_QUESTION_DCFE_28>

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<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>

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<ESMA_QUESTION_DCFE_29>

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

<ESMA_QUESTION_DCFE_30>

Yes, there might be new or exacerbated risks in relation to the 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.

In addition, such MAG are expected to have clear functional “Chinese walls” in place, including a strict need-to-know based segregation of controls. The objective is to ensure that larger firms that perform multiple functions in the financial value chain perform their controls independently. The business model of technology MAGs if typically built around data aggregation and correlation, including widespread sharing of data. These fundamentally different approaches to data can create risks in the execution of controls.

<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>

Yes, this risk might exist between individual financial firms and MAGs. MAGs might have some advantages in this field with a wider reach of potential investors. If funds were to be distributed by such platform, all Fund Promoter should have the same access (and the boycott of a distribution of a fund should be monitored and regulated).

<ESMA_QUESTION_DCFE_31>

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

<ESMA_QUESTION_DCFE_32>

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<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

<ESMA_QUESTION_DCFE_33>