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Ref: ESMA response to EC consultation on a new Digital Finance Strategy for Europe

Dear Mr Berrigan

ESMA is today publishing the response it submitted last Friday to the Commission's consultation on a Digital Finance Strategy for Europe, which was launched on 3 April. ESMA welcomes the Commission's consultation and notes that it builds on the 2018 FinTech Action Plan that set a number of deliverables for the ESAs, all of which were completed.

The digital transformation of the financial sector continues to have profound consequences for ESMA's objectives of protecting investors and ensuring stable and orderly financial markets, as we have highlighted in our response to the consultation. The Commission's strategic work in this area is therefore highly relevant to ESMA's own work.

ESMA continually monitors the rapidly-evolving environment for financial markets. We have carried out detailed analyses of a number of topics within our remit in recent years, such as Distributed Ledger Technology and Crypto-Assets. We have also witnessed significant trends in market structure, with the growth of many FinTech start-ups in recent years now accompanied by larger, established technology companies seeking to make inroads into the financial sector.

Based on our work, we have provided much detail in our response to the consultation. At a general level, our response identifies risks and benefits to digitalisation of the financial sector. Benefits include increased speed, efficiency, convenience and greater economies of scale. Automated tools can help firms and authorities detect cases of poor conduct, thereby enhancing the integrity of markets. However, we see a number of risks around digitalisation too. Digitalisation brings an increasing need for effective management of risks around data security, an operational risk that affects all entities within the sector. Other significant risks are especially relevant to consumers, including risks to privacy, a growing capacity for poor sales practices, price segmentation and even outright discrimination based on consumer data. Some

consumers may struggle to manage their finances online, and many of us may be subject to behavioural traits and biases that digital interfaces can accentuate. Finally, digitalisation may promote financial inclusion of some individuals but risk excluding others.

Our response goes on to raise many specific points in relation to the themes around which the consultation is structured. I would like to highlight some of these, as follows.

1) Ensuring a technology-neutral EU financial services regulatory framework that supports innovation

Based on its work in recent years, ESMA regards the regulatory framework as broadly technologically neutral. However, the existing regulatory framework was not necessarily designed with innovative technologies in mind. This can create challenges, which may include: (i) the need to clarify whether and how certain existing rules may apply to innovative business models and processes; (ii) the need to adapt certain existing rules to allow for an effective application of the existing rules; and (iii) the need for a coordinated response at EU and international level.

Our work regarding Crypto-Assets (CAs) highlights examples where risks may emerge that are specific to a technology. In this sense, technological neutrality may be consistent with a regulatory approach that focuses on a specific technology. Such an approach may in principle also promote innovation-friendliness.

More broadly, an EU-wide harmonised regulatory/supervisory framework is necessary to allow innovative firms in the EU to reach the scale that they need and provide for the necessary safeguards to investor protection, financial stability and orderly markets. In this context, the concept of technological neutrality should apply.

2) Removing fragmentation in the single market for digital financial services

An important way to address fragmentation in the single market for digital financial services is through cooperation at EU level. The European Forum for Innovation Facilitators (EFIF) established under the Joint Committee (JC) of the ESAs provides a platform for supervisors to meet regularly to share experiences from engagement with firms through innovation facilitators, to share technological expertise, and to reach common views on the regulatory treatment of innovative products, services and business models. EFIF work should be aligned with other ESA and JC workstreams. National innovation facilitators remain the appropriate level for authorities to handle questions from individual firms.

ESMA believes that certain specific initiatives would support the goal of removing fragmentation in the single market for digital financial services. ESMA notes the Commission's data strategy highlights the importance of electronic identification initiatives including eIDAS. Within ESMA's remit, electronic identification is relevant in the context of customer and firm-to-firm interactions, as well as for the publication of documents such as KIIDS, KIDs, prospectuses and annual accounts.

ESMA believes it would be important to develop Digital Financial Identities that are usable and recognised throughout the EU. A prerequisite for this task is the introduction of a unique standardised and harmonised means of identification. Such means already exist in the financial sector in the form of the Legal Entity Identifier, a global standard. It should be promoted to the maximum extent possible.

3) Promote a well-regulated data-driven financial sector

A challenge for firms, authorities and consumers alike is to build the necessary knowledge and expertise to fully reap the benefits of digital technologies.

Key requirements for efficient and easy use of data are data standardisation and harmonisation, security of IT-systems and legal certainty regarding pertinent responsibilities, liabilities and usage permissions. For publicly available data to be easily usable, they need to be subject to unrestricted access in a timely manner. Data quality issues should be addressed through robust verification mechanisms. Text data need to be in machine-readable format.

An important way in which data is driving the development of the financial sector is through AI-based tools. Firms use such tools for their business and for regulatory reporting. Supervisory authorities are developing their own SupTech tools, including examples that make use of AI. ESMA has begun exploring new AI-based applications. An area of particular interest is the potential for AI-based tools (such as machine learning) to support ESMA's statistics-related activities, such as flagging outliers and inconsistent entries in the databases that ESMA hosts.

The recent expansion in AI-based models is not limited to the financial services sector. Nevertheless, guidance for the EU financial sector could still be welcome, as a complement to horizontal-level EU rules on AI. It would also be necessary to incorporate privacy considerations into any horizontal-level rules, which would require a review of existing regulations in this area.

I will conclude by reiterating ESMA's support for the Commission's work in relation to digital financial services. We stand ready to provide any additional support as the Commission finalises its proposals for a new Digital Finance Strategy.

Yours sincerely,

[signed]

Steven Maijor
Chair
ESMA