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| Call for evidence |
| **Digital Finance** |

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](http://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](http://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](http://www.esma.europa.eu) under the heading [Legal Notice](http://www.esma.europa.eu/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:

1. Financial firms relying on third-parties, in particular technology firms, to fulfil critical or important functions;
2. Third-parties, in particular technology firms, on which financial firms rely to fulfil critical or important functions;
3. Technology firms providing financial services, either directly or through partnerships with financial firms;
4. Platforms marketing or providing access to different financial services;
5. 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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# 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]](#footnote-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]](#footnote-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.

# 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]](#footnote-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]](#footnote-4):
   1. 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;
   2. platforms and bundling various financial services;
   3. 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]](#footnote-5) – adopted on 15 December 2020 – and Digital Operational Resilience Regulation (DORA)[[6]](#footnote-6) intend to 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]](#footnote-7) for what concerns EBA or a Discussion Paper on the (re)insurance value chain and new business models arising from digitalization[[8]](#footnote-8) for what concerns EIOPA.

**General information about respondent**

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| --- | --- |
| Name of the company / organisation | European Fund and Asset Management Association (EFAMA) |
| Activity | Asset Manager Association |
| Are you representing an association? |  |
| Country/Region | Belgium |

1. 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>

No comments

<ESMA\_QUESTION\_DCFE\_1>

# More fragmented or non-integrated value chains

1. 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.
2. 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.
3. 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**

1. 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>

NowCP, a new entrant on the bond market, provides a useful illustration of the sort of changes we are seeing to the financial services value chain as a result of technological innovation. Such providers allow decentralized subscription of bonds from issuers without having to pass through Central Securities Depositories (CSDs). This is where we are seeing the development of Blockchain infrastructures for the subscription and trading of bonds. Decentralized infrastructure allows the market to be more diversified and therefore avoid the monopoly or oligopoly of traditional CSDs (which may be costly and less efficient or slower in their processes). However, we notice that if we want to sell such bonds we have bought through NowCPs, we have to pass back through NowCP.

Therefore, while digital innovation can open up access for new players creating more competition, it works only if this decentralisation and fragmentation are accompanied by Inter-Operability – which is not the case for the Bond market yet. Without interoperability, market participants will not benefit from fragmentation and increased competition among providers.

A similar observation can be made in the field of fund units’ settlement, with the arrival of new players such as Iznes or FundsDLT. In these cases, as well, we believe that decentralisation must be accompanied by inter-operability in order for market players to benefit from and advantage of such development linked to progress in digital technology.

The issue of inter-operability is even more concerning when some players have large market shares: they could easily make their blockchain non-operable with other blockchain-based distribution channels, fragmenting the market or potentially concentrating the risk on one provider.

Last, new entrants are now coming on the market for crypto-assets – with the same risk of fragmentation without interoperability. In addition, the Digital Finance package creates a segregation between DLT based use cases and crypto use cases, which can be understood from a regulatory monitoring standpoint. However, use cases where traditional assets could be distributed through crypto exchanges as a result must be discarded.

In terms of the impact of Covid, the outbreak of the pandemic has increased the pace and magnitude of those changes. Indeed, major financial firms have switched to a fully remote organization. For instance, meetings, exchanges and onboarding processes have been fully digitalized with professional clients. Some financial firms rely on turnkey solutions provided by Technology Firms to monitor those processes, store the data and interact with their clients.

Moreover, we have identified an evolution of cyberthreats and cyberattacks, both in the nature of threats and their numbers. In this regard, certain financial firms have been obliged to find structural responses, accelerating the adoption of new and more resilient technology-enabled financial services.<ESMA\_QUESTION\_DCFE\_2>

1. 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>

Asset Managers are users of technologies such as AI and Cloud services. In this regard, when it comes to AI, market players have mainly developed internal tools, and not necessarily increased the use of external AI service providers.

The same applies to fund depositaries/custodians: Asset Managers are still making use of traditional fund depositaries/custodians, even if the technology has evolved. As blockchain solutions emerge, and with it a decentralised model, it will be critical to understanding the liabilities attributed to fund depositaries/custodians versus those attributed to the fund managers.

At the same time, and as already alluded to in question 2, when it comes to increased technology and possible repercussions for financial firms, we note that there is an increased use of Cloud technology, with a trend towards outsourcing to third parties which are purely dedicated to this Cloud activity, such as Technology Firms. Often, these third-party firms are not used by asset managers directly, but by their service providers, such as Bloomberg . To manage these relationships, asset managers have started to put in place comprehensive vendor management systems.

Regarding our industry, in some cases we rely on Technology Providers to fulfil some important functions when these can facilitate the execution of such functions through their connectivity: e.g. for electronic trading, TradingScreen is used by us because of their very efficient connectivity with brokers from their single platform.

We also note that some traditional players are making use of new technologies to develop their activities. A few examples include: FORGE, a Technology Firm fully owned by Société Générale, used for the issuance of bonds based on Blockchain technology. The EIB, also, recently issued bonds through FORGE on an Ethereum Blockchain. And Allfunds is a fund distribution platform, which is now developing fund distribution supported by Blockchain technology.

For the issuance of Security Tokens, asset managers will have to rely on digital assets custody solutions offered by custodians. In this case, custodians either develop their own solution or rely on third-party providers. Security tokens are considered as assets not “held in Bank”, so the asset managers will take much more risks compared to the traditional issuance process. It was the case for the EIB Bond for example, with FORGE, ensuring the custody without being regulated.

We believe that technology and the development of technology firms, are at the heart of financial firms’ business. We fully appreciate the economies of scale made possible by the offering of technology companies, but also believe that these should be subject to the corresponding regulatory framework when offering a financial service. <ESMA\_QUESTION\_DCFE\_3>

1. 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>

See our answer to Question 3 above.

In addition, a lot of tokenisation use cases are relying on the Ethereum blockchain, which can be perceived as a risk or a concentration risk. Rules may have to be established to avoid blockchain risk concentration.

Digital Assets Custody of security tokens can be considered as financial services, while not regulated. This is the case of FORGE, CryptoFinance, Fireblocks, Curv which are providing services to financial institutions, not only for crypto but security tokens’ custody.<ESMA\_QUESTION\_DCFE\_4>

1. 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>

See above, e.g. TradingScreen.

<ESMA\_QUESTION\_DCFE\_5>

1. 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 (FMD) are provided by regulated data providers (RDP) as well as market data distributors (MDD). Major parts of financial market data are provided by EU regulated entities such as reference/static data, market data by regulated trading venues (RTV), Approved Publication Arrangements (APA), benchmark data, as well as credit rating data.

FMD are often procured not directly by data providers but by MDD - such as Bloomberg, Moody’s, Refinitiv, or Six Financial - who collect, catalogue and distribute them and who are not regulated as financial services providers.

Despite the improvements brought by the regulatory requirements included in MiFID II, CRAR, BMR and SFDR, we believe that the above-mentioned regulations do not entirely address remaining issues such as an increase in cost of financial data, lack of transparency on data providers fee policy and limitations of their liability when the data provided appear to be wrong.

We also observe that regulated financial services companies are currently escaping potential regulatory obligations by providing services and outsourcing their business to unregulated (group) companies. For example, Deutsche Borse Group is relying on Qontigo, a third-party non-regulated company, to outsource part of their business and circumnavigate regulatory obligations.

Similar challenges have been already addressed by ESMA in the sphere of credit rating data. In a report published in 2018, ESMA expressed concerns about the risks arising when the distribution by subscription of rating data and information is conducted by non-registered third companies falling outside of the control of registered CRAs, and therefore pose additional challenges to investor protection, transparency and disclosure. Moreover, ESMA has tried, without success, to obtain detailed rating cost and product information from the above-mentioned unregulated rating data companies and we fear that similar situations may arise with data companies associated with regulated trading venues or benchmark providers.

In June 2021, ESMA released the Final Guidelines on MiFID II / MiFIR obligations on market data setting out the requirements to publish market data on a reasonable commercial basis and to make market data available free of charge 15 minutes after publication. While we welcome the ESMA guidelines as we believe they set additional practical requirements to data providers in terms of transparency, we still encourage EU institutions to introduce binding requirements in MiFID Level 1 or Level 2, in order to strengthen the overall concept that market data should be charged based on the costs of producing and disseminating information (plus a reasonable profit margin). The same rules and principles should apply to all financial market data providers/distributors, both regulated and unregulated.

Crypto-assets: (Regarding Financial Market Data applicable to Crypto-Assets – e.g.KAIKO, is specifically providing Data on Crypto-Assets - we suspect that at this stage the MiFID obligations do not apply to such providers, as Crypto-Assets are not included in the scope of MiFID. This is another instance where it would be important for MiCA to introduce similar obligations on the provision of data as those found under MiFID. <ESMA\_QUESTION\_DCFE\_6>

1. 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 asset management industry plays an active role in the development of DLT based solutions for the issuance of mutual funds shares. Many asset managers are shareholders of FundsDLT or Iznes. The fund issuance model is the only case where asset managers can play an active role and discuss with those players in order to offer new services. The sub-issuance model relying on traditional fund depositaries/custodians as well makes it difficult to see changes in the potential value chain.

And as many new technologies appear from other parts of the market, e.g. for Blockchain (where issuers are critical players), these service providers impose their own conditions on us (e.g. fund depositaries/custodian).

In addition, a small number of players have started to offer crypto-related services only available to institutional investors. We predict that services to access crypto-assets and traditional assets will be fragmented for the end investor, as these do not fall under the same regulatory regime in the Digital Finance package. ( MiCA vs DLT pilot regime), traditional large asset managers cannot take an active part in these changes.

Finally, as various changes in value chains do appear, asset managers are active in choosing the most appropriate, efficient and cost-saving solutions, to the ultimate benefit of our end-users.<ESMA\_QUESTION\_DCFE\_7>

1. 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>

One risk might be in the risk assessments and due diligence asset managers typically carry out over their external service providers: traditional assessments do not always fit the new technologies used by new technology firms or the new markets they act on – e.g. for providers of crypto-asset trading platforms and custody. Therefore, it requires users to adapt their assessments over such technology firms, to carry them in an appropriate, satisfactory and safe manner.

On the development of security tokens, the main risk we see is the reliance on some public blockchain as a back end infrastructure of financial markets. Clear controls and risk management will have to be put in place in order to diversify public blockchain exposure risks.<ESMA\_QUESTION\_DCFE\_8>

1. 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>

As mentioned under question 6, we believe that, in order to guarantee investor protection and market stability and security, all market players – regulated as financial service companies or not – should be subject to the same regulatory rules and principles.

The becomes more complicated when new assets are not qualified as MiFID financial instruments. E.g. for MiCA, it will be important to make sure that all the rules applicable to reporting of MiFID financial instruments apply to crypto-assets too. E.g., the obligation of internal reporting within firms by staff when trading crypto-assets.

If the above is not addressed, this could create an unlevel playing field, as regulated financial companies will not be able to handle crypto assets, while they are the ones who have put high-level control frameworks.<ESMA\_QUESTION\_DCFE\_9>

1. 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>

**Rising Market Data Costs:** Data providers are constantly strengthening their dominant position in their respective market segments, creating several issues for market participants such as the increase in costs of market data with no clear link to its costs of production and dissemination, tight restrictions on what downstream use can be made of market data without further payments and refinement of their licensing models. The significant market power of these companies results in their ability to unilaterally set all contractual conditions, since the customers, like asset managers, cannot operate without the data provided by these firms. Rigorous rules and supervision of the entire financial market data business are crucial in order to maximize the economic benefits of financial markets.

Asset managers rely on large amounts of data, including from external unregulated data service providers. In line with our response to Q6 above, we believe that the same principles and rules should apply both to regulated and unregulated data service providers. Such interventions would help to overcome problems, notably in terms of investor protection and level playing field and could help the fluidity of financial markets.

In addition, if new types of assets are not qualified as financial instruments under MiFID – e.g., crypto-assets – the provision of market data related to these new types of assets is not yet regulated at all. Therefore, it is critical to make sure that MiCA introduces clear and robust provisions in this respect.<ESMA\_QUESTION\_DCFE\_10>

1. 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 particular, we need inter-operability to make the whole trade and post-trade infrastructures based on Blockchain not only more efficient, but also safer, for instance for facilitating trading of tokenised securities among the various participants to the Blockchain (including players regulated by MiCA: fragmentation of players is good for creating competition between newcomers and incumbants, but it must absolutely be accompanied by inter-operability reqirements to ensure a smooth functioning of the related markets.<ESMA\_QUESTION\_DCFE\_11>

1. 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>

See our answer to Q11 where we reiterate that Blockchain must be accompanied by inter-operability requirements.

In addition, the current EU proposals, e.g. the EU Pilot Regime on DLT/BlockChain, still give a central role to CSDs: this Pilot Regime should propose to go further in terms of decentralisation.<ESMA\_QUESTION\_DCFE\_12>

1. 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>

Definitely yes.

From a wider perspective, there is still a lack of cooperation in the area of financial supervision:

* Between securities regulators across borders; and
* Between securities regulators and central banks.

This is currently the case with Digital Finance, with an unclear sharing of responsibility and action between central banks and securities regulators, as well as many domestic initiatives that are not coordinated enough from a cross-border perspective.

That is why the EU Pilot Regime is an excellent first step in the right direction, to facilitate convergence – if not harmonization yet – across the EU in the area of DLT/Blockchain.

But these two axes of cooperation – cross-countries as well as cross-sectoral – should take place ideally at global level, to ensure that Europe, America and Asia for ,instance, evolve in the same direction.<ESMA\_QUESTION\_DCFE\_13>

1. 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>

See above.<ESMA\_QUESTION\_DCFE\_14>

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

<ESMA\_QUESTION\_DCFE\_15>

See above.<ESMA\_QUESTION\_DCFE\_15>

# Platforms and bundling of various financial services

1. 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.
2. 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.
3. 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.
4. 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**

1. 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 a starting point, we would like to note that the definition of platforms provided by ESMA is very wide and potentially encompasses a large number of services.

EFAMA’s subsequent response will focus on fund distribution platforms. Even when focusing on these providers, we are aware of a number of bundled solutions offered. These stretch across the value chain from ‘front office’ capabilities like digital engagement platforms, or fund selection capabilities, to product solutions in the case of model portfolios. Many of these fund platforms curate ‘shelfs’ of offerings from other technology providers and asset managers.<ESMA\_QUESTION\_DCFE\_16>

1. 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>

With regards to fund distribution platforms, we see them being most successful in a B2B and not B2C context. Many distributors of financial products prefer linking up to these platforms, as this provides them with almost instantaneous access to a large universe of investment funds. This means that fund distribution platforms have become, de facto, unavoidable for fund managers, as distributors expect to see funds on these platforms.

This development is not a recent one but the prominence of fund distribution platforms has increased steadily over the last couple of years. This is in part due, in our view, to the ever-increasing regulatory complexity of distributing funds and the ongoing digitalisation efforts throughout the financial industry. In a way, fund platforms are, thus, providing useful and helpful services in connecting fund managers with investors. With this in mind, we do not see their growing market power as a direct result of the Covid-pandemic but rather as a consequence of broader changes to the distribution landscape. That being said, it must be highlighted that due to a number of M&As in recent years, there currently is a huge concentration of activities among the four biggest fund platforms (such as Allfunds, MFEX, UBS/Clearstream and Fund Channel). Together, these platforms offer approximately EUR 2 trillion in AuM. This growing concentration makes fee transparency and legal certainty (e.g. on AML/KYC service) for fund distribution platforms paramount.

Another important element we would like to highlight is the changing pricing structure of platforms. Historically, platforms retained part of the overall retrocession fees which funded their operations. In recent years, due to the aforementioned complexity around retrocessions (in particular the MiFID quality enhancement test and strict disclosure requirements), we note that the payment of retrocessions has decreased (but not stopped) and been replaced by ‘platform fees’, especially for clean share classes that do no contain retrocession elements. We understand that this fee is charged on the basis of a fund managers’ overall asset under management that is offered on the platform. We also understand from members that, in the same instances, the overall fees charged can be significant. <ESMA\_QUESTION\_DCFE\_17>

1. (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>

While fund managers are using fund distribution platforms as a means to access, in particular, retail investors, it is important to note that it is the distributors who chose to conduct their services through platforms due to the ease-of-use of their services as a ‘one-stop shop’ allowing them access to hundreds of thousands of funds. Therefore, if fund managers want to keep working with certain distributors, they are indirectly compelled to put their funds on these platforms used by these distributors.

However, it must be noted that the platforms’ fees are, in most instances, borne by the fund manager and not the distributor. As previously mentioned, hybrid pricing models exist. On the one hand, platforms take a share of the retrocessions (of those shares that carry retrocession fees). On the other hand, fund managers are charged platform fees directly in relation to the AuM put on the platforms (these include retrocession-based and clean share classes). Overall, this makes the pricing structure very opaque for managers, but also towards end investors. We also understand that platform fees have increased in recent years. At times of increased cost pressure (also by ESMA) on fund managers to provide ‘value for money’, this adds additional pressures on fund managers considering the overall pricing of their products. <ESMA\_QUESTION\_DCFE\_18>

1. (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>

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

<ESMA\_QUESTION\_DCFE\_20>

We see the following opportunities in using fund distribution platforms:

* The most important one is probably the fact that with one single distribution agreement fund managers can reach hundreds of distributors. This allows fund managers without huge resources to provide funds to retail investors which would otherwise not be the case.
* KYC/AML is a key service provided by fund distribution platforms to fund managers, allowing the latter to benefit from scale efficiency.
* Transaction services facilitate tracking and reconciliation when there are issues on deals.
* Certain insights into our clients' holdings can enhance the services we can offer clients.

However, we would consider the following challenges as well:

* Platforms tend to revamp their service offering quite frequently. Some offer bundled services as some sort of “premium service package” and do not offer prices on individual services only.
* With regards to KYC/AML services, platforms do not always fully assume their role as regulated entities, with the necessity to perform suitable AML assessments taking into consideration risk factors and each specific situation. This can create reputational risk for fund managers but maybe also constitute a regulatory risk, depending on the regulator’s view for assessing the responsibility of platforms vs. fund management companies (especially when sub-distributors are using the platform services).
* Effective application of the MiFID value enhancement rules requires more transparency to investors from platforms on retrocession calculations including what part of the overall retrocessions are kept and/or handed back to distributors.

<ESMA\_QUESTION\_DCFE\_20>

1. 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>

While we do not consider any new/exacerbated risk stemming from fund distribution platforms, we believe that certain risks with regards to investor protection exist due to their unclear pricing models (towards the end investor) as well as risk to fair competition due to the concentration of market power in a number of big market players.

<ESMA\_QUESTION\_DCFE\_21>

1. (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>

Controls and processes are in place to oversee the specific risks emerging from the use of platforms.

We see specific risks emerging from the use of platforms that have to be properly assessed and managed. They include but are not limited to, ICT and security risk management as well as AML and Know-Your-Distributors procedures. We also see some fund managers struggling in their contract negotiations with platforms to clearly define and separate the legal liabilities arising from these risks.

These risks being considered, it is very hard for fund managers not to list their funds on the main fund distribution platforms due to the disintermediated nature of fund distribution throughout the EU.<ESMA\_QUESTION\_DCFE\_22>

1. 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>

We would consider it important to further analyse whether services provided by fund distribution platforms are properly regulated through the existing EU regulatory framework to ensure proper mitigation of the risks we highlighted previously. We would hope that this exercise and its inclusion into the existing legal framework would lead to lower fees for fund managers and more balanced contractual terms with platforms. In essence, we consider distribution platforms to be distributors, thus being regulated under the MiFID framework.

<ESMA\_QUESTION\_DCFE\_23>

1. 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>

Please see our response to Q23.

<ESMA\_QUESTION\_DCFE\_24>

1. 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>

With regards to fund distribution platforms, we do not see any challenges regarding the cross-border supervision of financial sector activities in the EU in case those activities are brought into the scope of the current legal framework. On the contrary, platforms in many cases, enable the distribution of funds cross-border throughout the EU.

<ESMA\_QUESTION\_DCFE\_25>

1. 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>

We would like to see further analysis by regulators and supervisors regarding fund distribution platforms, in particular regarding their market power in the overall distribution chain and their evolving pricing models for the services they render. It should also be considered whether a minimum regulatory framework dealing for fund (or also other types of financial instruments) distribution platforms is necessary, to ensure fair, clear and non-misleading pricing setting mechanisms to ensure both fair competition and proper investor protection.

<ESMA\_QUESTION\_DCFE\_26>

# Risks of groups combining different activities

1. 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.
2. 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.
3. 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.
4. 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**

1. 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>

No comments.<ESMA\_QUESTION\_DCFE\_27>

1. Which types of financial services do these entities provide?

<ESMA\_QUESTION\_DCFE\_28>

No comments.<ESMA\_QUESTION\_DCFE\_28>

1. 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>

No comments.<ESMA\_QUESTION\_DCFE\_29>

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

<ESMA\_QUESTION\_DCFE\_30>

No comments.<ESMA\_QUESTION\_DCFE\_30>

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

<ESMA\_QUESTION\_DCFE\_31>

No comments.<ESMA\_QUESTION\_DCFE\_31>

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

<ESMA\_QUESTION\_DCFE\_32>

No comments.<ESMA\_QUESTION\_DCFE\_32>

1. 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>

No comments.<ESMA\_QUESTION\_DCFE\_33>

1. [Digital finance package | European Commission (europa.eu)](https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en) [↑](#footnote-ref-1)
2. <https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/210202-call-advice-esas-digital-finance_en.pdf> [↑](#footnote-ref-2)
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’](https://www.esma.europa.eu/sites/default/files/library/esma_50-165-1040_trv_no.1_2020.pdf). [↑](#footnote-ref-3)
4. The EC is also asking EBA for input in the areas of protection of client funds and non-bank lending. [↑](#footnote-ref-4)
5. https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital-markets\_en [↑](#footnote-ref-5)
6. https://ec.europa.eu/info/publications/200924-digital-finance-proposals\_en [↑](#footnote-ref-6)
7. [https://www.eba.europa.eu/financial-innovation-and-fintech/fintech-knowledge-hub/regtech-industry-survey](https://eur02.safelinks.protection.outlook.com/?url=https%3A%2F%2Fwww.eba.europa.eu%2Ffinancial-innovation-and-fintech%2Ffintech-knowledge-hub%2Fregtech-industry-survey&data=04%7C01%7CClaudia.FernandezGarcia%40esma.europa.eu%7C82cd95d1500c4e54e94f08d90e21aad4%7Ce406f2684ae74c80899402493da00c03%7C0%7C0%7C637556360043904822%7CUnknown%7CTWFpbGZsb3d8eyJWIjoiMC4wLjAwMDAiLCJQIjoiV2luMzIiLCJBTiI6Ik1haWwiLCJXVCI6Mn0%3D%7C1000&sdata=dE7BJ3QNMEZoxDX2LYv8dhkKYzpDzkCuq%2FrwiF8K9TA%3D&reserved=0) [↑](#footnote-ref-7)
8. [EIOPA (2020). Discussion Paper on the (re)insurance value chain and new business models arising from digitalization](https://www.eiopa.europa.eu/sites/default/files/publications/consultations/discussion-paper-on-insurance-value-chain-and-new-business-models-arising-from-digitalisation.pdf). [↑](#footnote-ref-8)