

# REQUEST TO EBA, EIOPA AND ESMA FOR TECHNICAL ADVICE ON DIGITAL FINANCE AND RELATED ISSUES

## 1. Context and scope

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. However, it may also make it more challenging for the existing regulatory and supervisory frameworks to safeguard financial stability, consumer protection, market integrity, fair competition and security. The digital finance strategy (DFS) adopted in September 2020 therefore set out the Commission's intention to review the existing financial services legislative frameworks in order to protect consumers and safeguard financial stability, protect the integrity of the EU financial sectors and ensure a level playing field. To prepare these actions, the Commission is requesting advice from the European supervisory authorities (ESAs) on how to address "same activity, same risk, same rules" issues, more fragmented value chains, the scope of the supervisory perimeters, the prudential risks related to non-bank lending and the protection of clients' funds.

As one of the four priority areas and alongside other actions, the DFS sets out the Commission's ambition to adapt the EU's prudential and conduct regulation and supervision frameworks to be future proof for the new financial ecosystem, including traditional financial undertakings, technology providers and other new entrants offering financial services.

Boosting digital finance would support Europe's economic recovery strategy and the broader economic transformation. It would open up new channels to mobilise funding in support of the Green Deal, Capital Markets Union and the New Industrial Strategy for Europe. To this end, the DFS sets out a series of steps to facilitate the digital transformation of the EU financial sector in accordance with the principle of technological neutrality and a risk-based approach to financial sector regulation and supervision. This means that no technology should be given a preference over another. At the same time, the use of innovative technology should not be prevented due to inadvertent regulatory or supervisory barriers; an approach that is also neutral towards incumbents and new entrants.

Moreover, technology companies – large<sup>1</sup> and small – are increasingly entering financial services, reaching end-users either directly or indirectly (e.g. via cooperation with financial service providers). While such firms are now offering payments and related services, respondents to the Commission's public consultation<sup>2</sup> and participants in the digital finance outreach activities carried out in spring 2020 expect online provision of other financial services, such as loans, holding of client money, insurance, and asset management for consumers and businesses to develop further. Indeed, as is apparent from observations of other financial markets, some technology companies are increasingly acting as intermediaries by bundling various services and products with associated financial services, such as payments, financing or insurance and thus become marketplaces for financial services. They can scale up quickly thanks to their large user bases and may have the potential to radically change market

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<sup>1</sup> <https://www.fsb.org/wp-content/uploads/P091219-1.pdf>

<sup>2</sup> [https://ec.europa.eu/info/consultations/finance-2020-digital-finance-strategy\\_en](https://ec.europa.eu/info/consultations/finance-2020-digital-finance-strategy_en)

structures, something which can be efficiency and consumer-welfare enhancing but may also sometimes adversely affect competition. Notwithstanding the opportunities and benefits, preliminary evidence to date suggests that such concerns could be particularly pronounced as regards potential risks stemming from large-scale lending operations by firms outside the traditional regulatory perimeter, which could entail consumer protection as well as both micro and macro-prudential and conduct risks.

Furthermore, technology is contributing to breaking up previously integrated value chains for a given financial service, as incumbents and new entrants adopt new business models leveraging technology such as application programming interfaces (APIs) and platforms. A good example is the new ecosystem that is emerging in payments and account information services<sup>3</sup> as a result of the revised payment services directive (PSD2). Similar trends in other financial services could change or displace risks if not managed properly, especially if the entities involved are subject to different regulatory and supervisory frameworks, or even unregulated, leading to challenges for supervision and risk mitigation. This could be an issue for instance where start-ups are in co-operation agreements with incumbent financial institutions for the technology focused development or provision of a new or improved service. The relevance of technology firms for the financial service value chain is increasing, ranging from payments and banking to insurance services. Similar issues may arise in relation to the leveraging of digital platforms for the provision of financial (and non-financial) services.

Technology companies have already become an integral part of the financial ecosystem and this trend is likely to continue. Most respondents to the consultation preceding the digital finance strategy expect risks to increase in the event the regulatory and supervisory frameworks were not to adapt to the new business models. It is important to address any risks, affecting in particular customers and consumers (policy-holders, investors and depositors) and financial stability issues while ensuring fair competition in financial services markets and preventing the use of the EU's financial system for money laundering and terrorist financing (ML/TF) purposes.

International,<sup>4</sup> European<sup>5</sup> and national supervisors have assessed these market trends and the associated opportunities, challenges and risks from various perspectives. They drew attention to issues with competition and conduct, ML/TF risks, transparency and complaints management, operational dependency, concentration of funds and liquidity risks, increasing systemic risks, credit and financial stability risks. The ESAs have recently carried out in-depth assessments of BigTech in finance, the increasingly fragmented or non-integrated value chain in the insurance sector and more recently have been taking forward preliminary work regarding the leveraging of digital platforms<sup>6</sup> in insurance,

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<sup>3</sup> Following the implementation of the PSD2, it is estimated that there are about 250 licensed TPPs and about 300 banks offering TPP-like services across the EU.

<sup>4</sup> <https://www.fsb.org/wp-content/uploads/P091219-1.pdf>

<sup>5</sup> [https://www.eiopa.europa.eu/content/discussion-paper-reinsurance-value-chain-and-new-business-models-arising-digitalisation\\_en](https://www.eiopa.europa.eu/content/discussion-paper-reinsurance-value-chain-and-new-business-models-arising-digitalisation_en)  
[https://ec.europa.eu/eusurvey/runner/EBA\\_digital\\_platforms\\_survey\\_2020](https://ec.europa.eu/eusurvey/runner/EBA_digital_platforms_survey_2020)

<sup>6</sup> There are different definitions of platforms. According to EIOPA, a platform is the technical infrastructure necessary for multiple participants to connect and interact with each other, and create and exchange value. According to the EBA, a digital platform/platform enables at least one financial institution directly (or indirectly using a regulated or unregulated intermediary) to market to customers, and/or conclude with customers contracts for, financial products and services within the EEA.

banking and payments. They have also identified potential impediments to the cross-border provision of banking and payment services in the EU.<sup>7</sup> These assessments will bring relevant elements in the context of the call for advice. At the same time, the advice should capture the challenges and risks that sectoral and cross-sectoral developments bring for regulators and supervisors.

Finally, it should be noted that the legislative proposal for the Digital Markets Act (DMA)<sup>8</sup> – adopted on 15 December 2020 – 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. The 2020 public consultation on digital finance suggested that consumers would face new conduct risks which requires a new perspective from regulators. The DMA will address some of the conduct risks to consumers posed by the significant market power of the big tech companies, but the ESAs should continue to consider other potential sources of risks. Of course, the DMA will not deal with the risks usually covered by prudential supervision either.

As set out in the DFS, the Commission will, where necessary, adapt the existing conduct and prudential EU legal frameworks so as to continue safeguarding financial stability and integrity, and protecting consumers and other customers in line with the principles of technical/technological neutrality and “same activity, same risk, same rules”.

## 2. Procedure

The Commission requests the technical advice of the ESAs based on its Digital Finance Strategy, which sets out its work for the coming four years in this domain. The Commission may propose new legislations, amendments to existing EU legislations or take other actions. The technical advice of the ESAs will be a key input to this work.

The Commission reserves the right to revise and/or supplement this formal mandate.

The technical advice received on the basis of this mandate will not prejudice the Commission's final decision in any way. In accordance with the established practice, the Commission may consult other experts or seek other inputs.

The ESAs should consult the Joint Committee on the aspects that fall under the scope of the Committee.

The European Parliament and the Council will be informed about this request, which will be available on the website of the Directorate-General for Financial Stability, Financial Services and Capital Markets Union once it has been transmitted to the European Supervisory Authorities.

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<sup>7</sup> See in particular the EBA's October 2019 report:

[https://eba.europa.eu/sites/default/documents/files/document\\_library//EBA%20Report%20on%20potential%20impediments%20to%20the%20cross-border%20provision%20of%20banking%20and%20payment%20services.pdf](https://eba.europa.eu/sites/default/documents/files/document_library//EBA%20Report%20on%20potential%20impediments%20to%20the%20cross-border%20provision%20of%20banking%20and%20payment%20services.pdf)

<sup>8</sup> [https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital-markets\\_en](https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital-markets_en)



### **3. The ESAs are invited to provide technical advice on the following items**

#### **3.1. Regulation and supervision of more fragmented or non-integrated value chains**

As the DFS stated, the Commission will assess how to ensure comprehensive supervision of the more fragmented value chains and the new providers of financial services. Digitalisation and technological innovation can lead to more fragmented value chains in finance. Even though the use of third-party services and outsourcing is not new in the financial area, technological developments are increasing the extent to and ways by which financial services providers rely on third-parties in the delivery of services. This can be done through various ways, outsourcing, partnerships, cooperation agreements or joint ventures.

Financial services providers already cooperate closely with other financial and non-financial companies for the provision of a single financial service e.g. insurance undertakings with reinsurance undertakings, investment firms with clearing and settlement services providers, banks with payment service providers and payment card schemes. Further, some new market participants are cooperating with credit institutions in order to fulfil the safeguarding requirements set out in the respective directives. However, interconnections historically have been limited and based on relatively clear functional separation.

Technological developments and regulatory initiatives to reduce barriers to entry for new services and providers are changing the arrangements. For example, BigTech companies are partnering with regulated financial institutions to offer either non-financial services, such as cloud services which are necessary in the digital context, or financial services such as payment, insurance or lending services<sup>9</sup>. In its recent proposal on Digital Operational Resilience<sup>10</sup>, the Commission proposed to establish an oversight framework for critical third-party providers which are intended to address the risks stemming from this cooperation with these companies when offering cloud services providers to the financial industry. However, this framework does not address all the challenges and especially the prudential risks linked to the offering of financial services by BigTech companies.

In recent years, open banking – the opening up of the market for payment services to competition by bank clients granting companies access to their payment account information – has also triggered the development of innovative payment services requiring the cooperation of account servicing payment service providers and third-party providers (providing payment initiation and account information services). PSD2 has opened up the market for payment service providers (including those leveraging innovative business models) and required banks to cooperate with them. When initiating payment transactions, customers may use an app operated by a payment initiation provider but the transaction is executed by the account servicing payment service provider (often a bank). This way the service provision is based on more than one regulated payment service provider that are legally and economically separated. They need to operationally work together smoothly to ensure the quality and the security of the financial services. In the insurance sector, InsurTech companies are increasingly

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<sup>9</sup> Apple and Goldman Sachs partnered to offer a credit card; Google recently announced new partnerships with banks and credit unions in the US. Also in insurance, especially outside the EU. See e.g. <https://www.cbinsights.com/research/big-tech-insurance/>

<sup>10</sup> [https://ec.europa.eu/info/publications/200924-digital-finance-proposals\\_en](https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en)

partnering with insurers to offer new and more innovative services to customers, as set out by EIOPA in its recent Discussion Paper on the (re)insurance value chain<sup>11</sup>. These trends go beyond payments and insurance though, as similar issues arise from increasing reliance on third party service tech providers (e.g. technological systems, cloud, AI algorithms, etc.).

The joint provision of a single financial service by several specialised entities may lead to greater efficiency and overall benefits to the users of financial services. It could however also create new risks as the provision of a service is divided into parts, each executed by a separate entity which may be subject to different legal requirements. The existing regulatory framework may currently not sufficiently take into account such collaborative business models. However, it must be ensured that the appropriate requirements are followed by each actor within the chain of service providers, who jointly provide the service. The framework should also ensure that the requirements for each provider of the value chain are proportionate to the risks that they may create and that it is clear which actor maintains liability in different scenarios.

In the context of cross-border supervision, the multiple cooperating actors can also raise issues and questions about coordination between different supervisors involved, and about the legal responsibility for conduct, operational resilience of the entire value chain, and prudential treatment. For example, with multiple actors, including non-regulated technology companies, the consumer may need clarity on who is effectively responsible for providing the service and where to request information from, report problems to and request remedies from. Similarly, authorities also need clarity on the legal responsibilities of the various businesses and thus where they need to intervene.

#### **Request to the ESAs:**

The ESAs should in their respective areas monitor and if warranted report on new material developments in the evolution and fragmentation of value chains of single financial services driven by technological innovation and the entry of new market participants. The ESAs are requested to assess if and when more fragmented or non-integrated<sup>12</sup> value chains lead to unidentified or unaddressed risks in terms of notably financial stability, market integrity or consumer protection and what challenges they bring for supervisors. They should, if and when warranted, advise how to manage the overall risks of the value chain and in particular advise on how to ensure a holistic approach to regulation and supervision.

The advice should pay particular attention to regulatory and supervisory challenges (prudential, AML/CFT and conduct) stemming from (i) cooperation among regulated providers active in multiple subsectors of financial services (e.g. retail financial services, payments, investment services, insurance) and established in one or various Member States in the EU, (ii) cooperation between technology companies – in particular BigTech firms – and financial service providers established in one or various Member States in the EU, (iii) cooperation among multiple subsectors of financial services and non-regulated companies operating in the EU but established outside the EU.

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<sup>11</sup> [https://www.eiopa.europa.eu/content/eiopa-consults-reinsurance-value-chain-and-new-business-models-arising-digitalisation\\_en](https://www.eiopa.europa.eu/content/eiopa-consults-reinsurance-value-chain-and-new-business-models-arising-digitalisation_en)

<sup>12</sup> I.e. value chains that are not entirely controlled by the same economic entity.

### **3.2 Platforms and bundling of various financial services**

Platforms can market or provide access to multiple financial services, often from various service providers such as payments services, payment accounts, lending, investment, and insurance products. Financial services providers operating digital distribution channels can also cooperate with new fintech companies to bundle a range of financial services. These service providers may form part of the same company or group as the platform provider or be provided by third parties which may or may not belong to the same corporate group and potentially be licenced in different Member States or outside of the EU. The different financial services bundled on the platform may fall under separate sectorial regulations and supervisory arrangements, or may potentially fall outside of the scope of the EU financial services regulatory perimeter, as may be the case for some lending activities (see section 4.1). The traditional regulation and supervision of financial services are sector-based and often have a single focus, e.g. banking, insurance, investment services. Hence, currently, the supervision of the various services marketed or offered together may be conducted by multiple national and EU supervisory authorities. The platforms are not typically subject to any holistic regulation nor supervised in a holistic way. However, they could pose a compound risk with the bundled products as regards e.g. interaction with consumer and customer protection, conduct of business, ML/TF risk, operational risk etc. This compound risk might not be captured fully or adequately by the current regulatory or supervisory setup largely based on sectoral lines.

#### **Request to ESAs**

The ESAs are requested to assess the extent to which platforms that operate across multiple Member States to market or provide various financial products and services are effectively regulated and supervised. Keeping in mind broader Commission policy objectives, such as the creation of a Capital Markets Union, they should advise whether there is a need to extend or modify current EU financial services regulation and whether there is a need to enhance supervisory practices, including through convergence measures. The ESAs should take into account the supervisory perimeters of the legislation already in force or already adopted (e.g. Regulation on European Crowdfunding Service Providers, ECSP). They should also assess if current supervisory capacities and skill are adequate for monitoring such online services and enforcing rules and provide such advice as appropriate.

### **3.3. Risks of groups combining different activities**

Sectoral legislations have been developed to manage the specific risks that each financial sector and activity represents. For example, stringent regulations are justified when it comes to risks related to deposit taking activities. In these cases, in addition to the solo supervision of the individual banks in a group, supervision on a consolidated basis is also required, so that the risks of the entire banking group, i.e. including all relevant financial institutions within that group, are duly taken into account for the purposes of the prudential supervision. However, with respect to banking rules, the current consolidation perimeter does not include technology companies for instance when they are not considered as financial institutions or specific ancillary services undertakings. This may lead to i) unlevel playing field and ii) unaddressed risks and supervision gaps that could become more important in the context of technological innovation.

In terms of level playing field concerns, under current rules, specific entities belonging to a banking group may face different requirements than those operating outside such a group due to the particularly strong policy imperative of ensuring the safety and soundness of banking groups and the banking system. Technology companies can provide financial services and compete with banking groups without the additional requirements coming from the consolidation rules. It needs to be analysed if this gives rise to level playing field issues and, if so, how these could be addressed.

In terms of the risk of mixed activity groups, large technology companies active in various sectors (e.g. social media, e-commerce, transport) may increasingly enter financial services, including by establishing their own subsidiaries for the provision of financial services. This can pose new challenges for regulators and supervisors.

First, large technology companies have significant capacity to quickly scale up the offerings of their financial services and may pose additional risks compared to small operators without such capacity. This may need to be addressed by adjusting EU legislation.<sup>13</sup>

Second, large technology companies offer a wide range of services and have elevated intra-group dependencies, for instance on integrated data pools, operating systems and processes, and customer access. They may use their vast amount of customers' data to support the provision of financial services giving rise to questions about conduct and prudential risk management, which have not been present so far in traditional mixed activity groups. These taken together suggest that they pose risks of a more systemic dimension. Hence a holistic approach to their supervision may be necessary.<sup>14</sup>

Existing sectoral financial legislation (banking, investment services, insurance) embed already an approach for group supervision. On top of those, the financial conglomerates directive (FICOD) requires a supplementary supervision aimed at identifying and addressing risks of groups that provide different financial services. Those frameworks also partly tackle the issue of financial and non-financial services (with mixed financial groups and mixed activity groups requirements). However, emerging types of mixed activity groups are not covered by a framework that facilitates coordinated supervision on a cross-sectoral basis, as their financial activities usually represent only a limited share of their total balance sheet or may only have a limited number of entities identified as financial undertakings in scope of the prudential sectoral rules. Even when the group has a specialised financial subgroup, sectoral financial legislations would only apply to that subgroup, with limited possibility to supervise and prevent risks stemming from the interactions between that financial sub-group and the broader group.

Furthermore, groups' prudential supervision requirements are mainly focused on addressing group-level capital adequacy, risk concentration, intra-group transactions, internal control mechanisms and risk management procedures. Additionally, they only scope-in 'regulated entities' within the financial group. Finally, the 'competent authorities' participating in supervision are limited to the authorities empowered to supervise (from a prudential perspective) 'regulated entities' in the group. This means

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<sup>13</sup> In one specific case, for example, relating to asset-referenced tokens regulated under MICA, the Commission has proposed additional, more stringent requirements for significant operators. This approach of imposing more stringent requirements on larger firms that may pose risks to the EU financial system as whole builds on similar approaches in regulation and supervision of other financial firms (e.g. significant banks under CRD/CRR and significant investment firms under the IFD/IFR).

<sup>14</sup> The Next Generation of Financial Conglomerates: BigTech and Beyond, Elisabeth Noble: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3693870](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3693870)



that supervisory blind spots might exist, because (i) some types of risk might not be (or not sufficiently) reflected in EU legislations, (ii) competent authorities may lack supervisory powers in relation to potentially significant non-financial companies of the groups they supervise, and (iii) the focus of prudential supervision might be too narrow when considered in the context of wider policy developments.<sup>15</sup>

### **Request to the ESAs:**

In terms of level playing field, the EBA should assess (i) whether current approaches to group regulation and consolidated supervision that aim to address the risks of regulated financial groups at consolidated level could be detrimental to a level playing field between entities providing the same financial services as part of a group versus as a single entity, and (ii) whether there are areas where targeted adjustments to the EU regime could be considered without endangering prudential soundness and safety. While these issues have predominantly been raised in banking, the ESAs should assess the situation in other sectors such as investment firms and insurance groups, and more generally mixed activity groups going through digital transformation. They should also advice on the potential need for adjusting the associated legislations.

In terms of mixed activity groups, first, the ESAs are requested to analyse new emerging risks in relation to mixed-activity groups, in particular large technology companies with a significant activity outside the financial sector marketing or providing financial services. The ESAs are requested to assess whether current licencing practices and regulatory requirements are adequate for large mixed activity operators that gain significant market share or have particular business models in payments, lending, holding customer funds, and/or insurance and investment or whether these providers should be required to fulfil more stringent and proportionate requirements. The ESAs should also assess whether existing EU legislation address these risks, or whether adjustments would be needed.

Second, the ESAs are requested to analyse the potential need for a new cooperation and coordination arrangements between financial supervisors and if needed other (data, competition) authorities in order to ensure effective supervision of emerging new types of mixed activity groups. The ESAs are requested to advise, where warranted, on how to adjust the supervisory arrangements relative to mixed activity groups, in particular large technology companies that build up substantial market share in financial services. The advice should also focus on (i) whether large technology companies (with substantial market share) in financial services as mixed activity groups should be supervised specifically; (ii) how interdependencies with, and potential risks stemming from, the financial and non-financial part of the business can be identified and addressed; and, (iii) how supervisory cooperation within the EU and with third countries can be improved for these companies and groups.

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<sup>15</sup> The Next Generation of Financial Conglomerates: BigTech and Beyond, Elisabeth Noble

## 4 Additional requests for technical advice from the EBA

### 4.1 Non-bank lending

In accordance with the DFS, the Commission is considering the need for legislative proposals to address potential micro and macro-prudential risks stemming from potential large-scale lending operations by firms outside the EU-financial services regulatory perimeter. Credit intermediation by companies that are non-banks is not a new phenomenon; it has been on the radar screen of regulators for many years.<sup>16</sup> These entities may include financial leasing, factoring, mortgage lending and consumer lending companies or other types of undertakings, also depending on Member States' national rules and frameworks. While these activities are mostly carried out within their local markets, there is increasing evidence that the use of innovative technologies to reach new customers, including potentially cross-border, is putting pressure on traditional local models.<sup>17</sup> At the same time, the absence of a common EU framework for such activities may be holding back a source of cross-border credit provision, which could help support the recovery of the economy. As not all Member States regulate non-bank lending activity at national level and for all forms of credit provision, and where they do requirements may vary, this leads to differential treatment across Member States.

New digital means to market and provide access to products and services can make it easier for firms to reach new customers locally and cross-border. Existing firms and new market entrants, such as e-commerce platforms, telecommunication firms and other large technology companies or other entities whose main activity is not currently the provision of financial services, may seek to use their competitive advantages of a wide user-base or specific user-data that they hold in order to provide credit,<sup>18</sup> potentially increasing the flow of credit outside the traditional perimeter of EU banking regulation. In particular, leveraging existing customer bases, these firms would have the potential to substantially scale it up in a short time frame. So-called value added-services, such as credit scoring,<sup>19</sup> provided by some firms on the basis of aggregated account information (including from non-payment accounts) could further facilitate credit provision, while at the same time potentially making it difficult to distinguish between the regulated (e.g. account information services under PSD2) and the non-regulated service.

However, credit provision outside the EU regulatory perimeter (Capital Requirements Directive and Regulation (CRR/CRD), the new European Crowdfunding Service Providers (ECSP) Regulation, Alternative Investment Fund Managers and amending Directives (AIFMD), as well as activity-based legislation like

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<sup>16</sup> For example, see the European Banking Authority's November 2017 Opinion and Report on Other Financial Intermediaries: <https://eba.europa.eu/eba-publishes-an-opinion-and-report-on-regulatory-perimeter-issues-relating-to-the-crd-div-crr>

<sup>17</sup> Although they are outside the banking regulatory perimeter they are subject, in some cases, to activity rules (e.g. Consumer Credit Directive, Distance Marketing of Financial Services Directive, Mortgage Credit Directive).

<sup>18</sup> For example, according to Oliver Wyman, Amazon began its lending business in 2015 with credit cards and the Amazon Credit Builder program in partnership with Synchrony Bank. In 2011, it entered merchant lending by launching Amazon Lending in the United States, offering revolving credit for small and medium sellers in the Amazon e-commerce platform using Amazon's own capital or bank partners' funding (for example, BAML). It scaled its activities to \$1 billion in loan origination in 2018, the equivalent to a mid-sized national SME lender in the United States. Source: Oliver Wyman: Big banks, bigger techs, 2020

<sup>19</sup> There are increasing risks of credit scoring based on data, which can deny access to some services.

the Consumer Credit Directive (CCD) and the Mortgage Credit Directive (MCD) gives rise to a number of challenges for regulators. The diversity of business models across the industry poses significant challenges for practitioners and policymakers alike. These challenges include ensuring adequate consumer and investor protection and level playing field between different types of lenders (with similar underlying risk characteristics), and the timely assessment of overall financial stability and economy-wide risks.<sup>20</sup> The challenges and benefits may become greater if market participants make more extensive use of their competitive advantages and market position.<sup>21</sup> This could, if it were to reach a certain scale, result in a significant portion of loans being received from entities which are not under the EU's regulatory perimeter. The possible associated risks related to credit, liquidity, leverage, and operations and pro-cyclicality should therefore be evaluated. These risks are addressed by EU banking regulations and other sectoral legislation (i.e. AIFMD and ECSP) but other entities carrying out lending activity, including BigTech companies that may choose to provide credit pursuant to national regimes, may remain outside the scope of these regulations (especially for business-to-business models). They may also not be subject to adequate authorisation processes at national level including inclusion within a register and proper supervision whilst they are active in cross-border lending activities. Furthermore, financial institutions', banks' exposure to other financial intermediaries (OFIs) is a channel where contagion and step-in risk could cause wider problems.

In addition, further consideration should be given to the cross-border provision of retail financial services by OFIs (outside the scope of CRR/CRD/ECSP/AIFMD), including unregulated digital platforms offering financial services or those operating under a national framework. They benefit consumers, as it fosters competition and expands the offer available to consumers. However, it also may pose challenges regarding the distribution of responsibilities between the home and the host competent authorities which are or would be responsible for supervising those activities. In particular, the application of consumer protection provisions (i.e. which national consumer protection requirements apply and how to supervise them), AML/CFT supervision, and the monitoring of their business conduct pose large challenges. Most of these entities, which are active cross-borders, may not benefit from existing EU passports<sup>22</sup> (e.g. the ECSP Regulation, as falling solely under the MCD or the CCD), which creates challenges in terms of legal uncertainty and resulting in different treatment of these platforms from one Member State to another, and barriers for firms as they seek to navigate applicable obligations under national regimes.

#### **Request to the EBA:**

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<sup>20</sup> Fintech and big tech credit are growing to sizes that could be relevant to financial stability. In specific markets, for instance small businesses lending in the United Kingdom and China, and consumer lending in Kenya, Fintech and big tech lending have a significant market share. Some big tech players (particularly in China) have likely reached a level of systemic importance. Moreover, as credit has grown rapidly, there is the potential for individual borrowers to become over-indebted, and – as in past periods of rapid credit growth – even for risks to financial stability. Source: BIS Fintech and big tech credit: a new database, 2020 <https://www.bis.org/publ/work887.pdf>

<sup>21</sup> Source: BIS Quarterly Review, September 2018,, Fintech credit markets around the world: size, drivers and policy issues [https://www.bis.org/publ/qtrpdf/r\\_qt1809e.pdf](https://www.bis.org/publ/qtrpdf/r_qt1809e.pdf)

<sup>22</sup> Loan originating Alternative Investment Funds (AIF) benefit from the passport held by the licenced AIFMs. Currently the requirements applicable to the loan-originating AIFs are national.

The EBA is requested to examine to what extent lending<sup>23</sup> provided by financial intermediaries outside of the pan-European financial services regulatory perimeter (i.e. entities under the scope of CRR/CRD, ECSP and AIFMD), including as applicable by technology companies and digital platforms, exists in the EU and may evolve recognising the deployment of innovative technologies as a means to reach new customers. In particular, the EBA should (i) report on the business models and legal structures employed, (ii) identify any regulatory and supervisory issues that may impede, on the one hand, effective risk management at both a micro and macro level, and on the other, scaling up of services cross-border and (iii) assess to what extent these activities are not (sufficiently) covered by other EU legislation, such as the CCD and the MCD.

The EBA should advise on any potential need to adjust the EU regulatory perimeter especially taking account of (i) the potential for the scaling up of these types of lending activities in light of the deployment of innovative technologies, (ii) the national rules in place to regulate these activities and to what extent is the approach homogenous across Member States, (iii) uncovered issues/risks not addressed, considering also the actual or potential carrying out of the activities cross-border. The EBA should develop and propose policy options to address any identified issues, taking into account the necessity of establishing specific authorisation, passporting, prudential requirements, conduct, consumer protection and supervision arrangements at both the domestic and cross-border level.

#### **4.2 Protection of client funds and the articulation to the deposit guarantee scheme directive (DGSD)**

The payment services directive (PSD2) and the e-money directive (EMD2) contain safeguarding requirements in the form of provisions applicable to client funds held by payment and e-money institutions. Those provisions for instance foresee that deposits received from the payment service users for the execution of payment transactions should be safeguarded by depositing them in a separate account in a credit institution, by investing them in secured low-risk liquid assets or by covering them with an insurance policy. Similar safeguarding requirements apply to e-money institutions. In the event client funds are deposited in a credit institution, they could benefit from the protection of a deposit guarantee scheme (DGS) in line with the DGSD. Investment firms are also required to place promptly the received client funds into an account opened with a credit institution, unless they choose a different way to safeguard the funds. In addition, investor compensation schemes protect investors in the event of an investment firm's inability to repay money or return instruments held in connection with investment business. Based on anecdotal evidence, some credit institutions offer deposit-like services to other financial service providers that operate electronic platforms and gather the client funds in a single account held in the first credit institution. There is limited data on how wide-spread this practice is in the EU.

In this context, the EBA recommended to clarify the treatment of any deposits placed with credit institutions by the account holders such as payment or e-money institutions and investment firms, excluded from repayment by a DGS.<sup>24</sup> The Commission intends to evaluate and clarify the DGSD in the

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<sup>23</sup> Lending provided by undertakings not authorised as “credit institutions” pursuant to Directive 2013/36/EU (CRD).

<sup>24</sup> EBA opinion on the eligibility of deposits, coverage level and cooperation between deposit guarantee schemes, 8 August 2019, see pages 61-71, Opinion on the DGS payouts of 30 October 2019, see pages 69-80.

ongoing review, taking note of the majority view supporting the protection of such funds by the DGS subject to Article 7(3) DGSD, as expressed in the Commission Expert Group for Banking, Payments and Insurance.

There is also merit for further analysing the 'precise moment' when the client funds become a deposit. To our knowledge, the timing depends on the type of institution and its respective safeguarding requirements as some are asking to deposit the client funds received 'promptly' or 'no later than by the end of the business day following the day when the funds were received'. This could potentially create a discrepancy between the extent of protection granted to the investment firms and the payment and e-money institution and their clients.

#### **Request to the EBA:**

For purposes of the Commission's impact assessment of the above review, the EBA should advise on the implications of the DGS protection of the client funds held by financial firms, such as payment and e-money institutions, investment firms or other financial technology companies. In addition, the advice should discuss the advantages and disadvantages of such protection through Article 7(3) DGSD, as well as the conditions allowing to preserve the level playing field between non-banks and banks. The EBA should also (i) map how often credit institutions are used to fulfil the safeguarding requirements, (ii) at which point in time and how often the client funds are deposited, (iii) what the deposited volumes are and (iv) whether these placements cause potential concentration risk.

The EBA should also analyse (i) potential misconduct which could lead to detriment to existing customers and consumers, and (ii) potential discrepancy between the extent of deposit protection granted to customers of different financial institutions.

Based on this analysis, the EBA should, if appropriate, propose concrete amendments to the DGSD framework.

#### **Final considerations**

The deadlines for this call for advice are the following:

By 31 July 2021 an interim report and by 31 October 2021 the final report on the protection of client funds (chapter 4.2) should be delivered by the EBA in consultation with the ESMA in relation to the investment firms.

By 31 October 2021 a joint interim report and by 31 January 2022 the joint final report on the value chains, platformisation, and mixed activity groups (chapter 3) should be delivered by the three ESAs.

By 31 December 2021 an interim report and by 31 March 2022 the final report on the non-bank lending (chapter 4.1) should be delivered by the EBA.

It is recalled that the advice provided will not prejudice the Commission's final decision on any follow-up in terms of legislative or non-legislative actions.