ESMA - Risposta consultazione in materia di finanza digitale

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General observations

The digital transformation of the economy is taking on an important role also in the world of asset management.

The use of artificial intelligence (AI) systems, distributed ledger technology (DLT), to which the blockchain technology belongs, and open finance represent some of the main technological challenges of the asset management industry as well as (and consequently) the object of growing interest by European and international regulatory authorities in search of a fair balance between the need to foster innovation and the need to limit potential risks for the stability of the financial system and the protection of investors.

Artificial intelligence systems. It is widely recognized that artificial intelligence systems – i.e., according to the recent European Commission proposal on artificial intelligence- COM(2021) 206 final - "software that is developed with one or more of the techniques and approaches (…) and can, for a given set of human-defined objectives, generate outputs such as content, predictions, recommendations, or decisions influencing the environments they interact with" - allow asset

managers to optimize investment processes, make operational processes more efficient, ensure greater personalization of products for customers.

However, as reported by IOSCO (the International Organization of Securities Commissions) in the consultation document of June 2020 entitled "*The use of artificial intelligence and machine learning by market intermediaries and asset managers*", the extensive use of artificial intelligence for managing investment products or for producing investment advice exposes asset managers to greater risks, making it necessary to adopt certain measures for their mitigation, including: (i) adequate governance, internal control and oversight measures with respect to the development, testing, use and monitoring of artificial intelligence systems; (ii) adequate knowledge, skills and experience of personnel to implement, monitor and question the results of artificial intelligence systems; (iii) development and testing processes suitable for allowing the identification of potential problems before the full implementation of artificial intelligence systems; (iv) transparency and disclosure measures towards investors, regulators and other interested parties.

The need to adequately understand and manage, especially in times of stress, the risks deriving from the use of digital technologies, or information and communication technologies, is also the prerequisite for the European Commission's proposal for a regulation on digital operational resilience in the financial sector (DORA) of last September, which aims to introduce, taking into account the principle of proportionality, both uniform and transversal rules on ICT security for all operators in the financial sector (including asset managers) and a European regime of direct oversight on critical ICT service providers for the financial sector, based on an oversight framework that provides for the sharing of roles and responsibilities between European (EBA, ESMA and EIOPA) and national Authorities.

Digitization of activities. Even the DLT technologies (i.e., the technologies that support the distributed recording of encrypted data) lend themselves to opening interesting opportunities for the world of asset management, especially when we consider the so-called process of digitization or tokenization of assets, i.e. the conversion of the rights on an asset into a digital token registered on a blockchain, where the material asset and the token are connected by a smart contract (which represents the transposition into code of a contract, with the ability to automatically verify the fulfillment of certain conditions and to carry out actions or give instructions in those cases).

This process, in addition to allowing an acceleration of transaction times and a reduction of operational costs, by operating with tokens registered on an immutable and transparent ledger, also entails important benefits in terms of liquidity and accessibility of the investment. In fact, through the tokenization of assets and, in particular of the typically illiquid ones - such as real estate, infrastructures, private equity funds, venture capital, Eltif - tokens can be traded on a peer-to-peer token market which, in the presence of a large base of investors, increases liquidity for the benefit of investors, who have greater freedom of entry and exit.

Examples of tokenized funds already exist both in the US market and in some European countries. Thus, for example, on 6 July 2020, the SEC approved, pursuant to the Investment Company Act of 1940, the first public offering of shares issued in the form of digitized securities, of a collective investment undertaking established in closed ended form, which operates as a so-called "interval fund". In this case, the tokens representing the fund's shares are issued on the Ethereum blockchain, one of the largest public blockchains in the world that uses the ERC-1404 protocol which allows, compared to the better-known ERC-20, the application of restrictions to the transfer of tokens within the relative smart contract, and therefore to control, among other things, the conditions under which the tokens can be transferred.

The phenomenon of tokenization of assets is also in the spotlight of the European Commission which,

in an attempt to create an EU framework that allows both the introduction of markets for crypto-assets and the tokenization of traditional financial assets and a wider use of DLT in financial services, published last September two regulatory proposals on markets in crypto-assets and on the pilot regime on DLT market infrastructures, and a proposal for a directive aimed at allowing the achievement of the objectives enshrined in these regulatory proposals. It is interesting to underline that Article 6 of the proposed directive amends the definition of "financial instrument" contained in MiFID II to clarify that such instruments can be issued using a distributed ledger technology. This is an important clarification from the perspective of asset managers because it allows a collective investment undertaking both to invest in financial instruments issued using a distributed ledger technology (so-called security token) and to issue units or shares as part of a digital tokenization process. For AIFs, the possibility would then open up to invest in crypto-assets other than financial instruments, falling within the Commission's regulatory proposal on markets in crypto-assets.

The investment in tokenized assets also highlights the emergence of new risks associated with the use of DLT technologies, including: (i) the possibility of unknown technical defects; (ii) the possibility that the security measures that authenticate transactions may be compromised or "hacked"; (iii) the possibility that new technologies or services inhibit access to a blockchain. In order to manage this new type of risk, on February 26 the SEC "Division of Examination" published a risk alert on investment or trading in "Digital Asset Securities". To make the tokenization process safer it is necessary that (1) it develops in compliance with precise normative-regulatory guidelines (regulatory framework) issued by the supervisory authorities; (2) it is based on precise standards recognized by the market and by operators; (3) it is based on DLT governed by authorized and supervised entities. 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 be established to avoid blockchain risk concentration.

Open finance. Finally, please consider the initiatives launched by the European Commission on the so-called open finance, a term that designates an extension of "open banking" (i.e., the practice of sharing banking data through standardized and secure interfaces at the request of customers) to the entire financial sector. In its Communication of 24 September 2020 on a Digital Finance Strategy for the EU, the Commission expressed its intention to define, by 2024, an open finance framework, in line with the EU strategy for data. According to the Commission, the open finance framework should also build on initiatives related to digital identities, including the definition of a robust regulatory framework that allows the use of interoperable solutions for digital identity, so as to enable new customers to access financial services quickly and easily ("onboarding").

These initiatives are based on the assumption that open finance can lead to an improvement in financial products, targeted advice and access for consumers, as well as greater efficiency of business-to-business transactions. Access to more customer data would also allow service providers to offer more personalized services and more in line with the specific needs of customers. The Financial Conduct Authority (FCA) also highlighted the benefits deriving from open finance, in its Feedback Statement on open finance (FS21/7) of last March, however, it also focused on highlighting some risks deriving from this initiative, especially in the area of the so called "data ethics". For this reason, the FCA suggests pursuing a gradual approach to open finance, trying to exploit its benefits without imposing (or at least limiting) excessive burdens, costs and uncertainties on companies.

Given the above, in answering to the following questions (in particular with regard to the Italian context), we have taken into account opinions and interventions made by Italian authorities in various contexts.

Scarica la versione integrale della risposta alla consultazione [2].

Risposta al documento di consultazione recante "Digital Finance".
