Summary of Conclusions

EFIF conference call, October 2022

1. Opening remarks by Claudia Guagliano, Chair of the EFIF

ESMA opened the meeting by welcoming participants; highlighting EFIF achievements in 2022 (e.g. adoption of the cross-border testing framework, launch of the EU Digital Finance Platform, improvements in data collection, discussions of cross-border testing) and thanking national authorities, the EC, the EBA and EIOPA for their cooperation and support.

2. Innovation facilitators: Update on Developments

Based on the input provided in the innovation facilitators Newsletter, EFIF members shared updates on 1) the developments in the design and operation of their innovation facilitators (e.g., plans regarding a sandbox, changes in staff, performance assessments, etc); and on 2) the innovative products and trends identified through the hubs and sandboxes. This time most members reported on the number of requests/inquiries received through their innovation facilitators as well as the distribution of such requests across innovations further enabling the EFIF to conduct comparative analyses across the EU.

Discussion: In the tour-de-table, members discussed and compared the inquiries they received through the innovation facilitators and the way they addressed them, including portfolio management in relation to crypto assets (reported as one of the prominent topics in several innovation facilitators); challenges in assessing cases against the "genuinely innovative" criteria; persistent (and sometimes increased) interest to NFTs; benefits of focusing on specific topics in the activities of innovation facilitators (e.g. only on AI). Several members observed a decline in the total number of requests received in their innovation facilitators (one member sees it as a temporary trend); while one member highlighted that the number of questions remained stable in the period since May 2022. Several members highlighted that the questions they receive become more complex and mature (in terms of quality). One member updated on change in tax treatment of data centres including cryptocurrency miners that would no longer be able to enjoy cheaper electricity in this jurisdiction. The OECD (attending the meeting as an observer) provided highlights of their technical support project with the Czech Republic. Members supported the EFIF practice of sharing the data on the number and types of innovations they deal with and suggested improvement for further reporting: a common reporting period; a common and agreed by all members innovations taxonomy; separating cases dealt with in the innovation hubs from those in regulatory sandboxes.

3. EFIF Work Programme for 2023

- **Presentation by the EBA**

The EBA as the Chair of the EFIF for year 2023, presented the EFIF Work Programme (WP) that the ESA JC adopted in October 2022. The key deliverables for 2023: 1) updating the 2019 joint ESA report on regulatory sandboxes and innovation hubs; 2) developing a cross-sectoral mapping of financial services offered by Mixed-Activity Groups (MAGs) via innovative distribution models; 3) updating the EFIF Financial Innovations Mapping, and 4) supporting cross-border testing.

Discussion: Overall members supported the WP for 2023 and raised several questions on practical implementation of the WP including timeline, focus, milestones, and contributions expected from members. In particular members supported the EFIF plan to update the ESA report on innovation hubs and sandboxes and expressed an expectation to include in this report cost-benefit analyses of sandboxes for small jurisdictions (considering that at present some small countries observe low or even negative RoI for sandboxes).

4. Update on the EU Digital Finance Platform. Banco de España pilot project on synthetic data.

— **Presentation by DG FISMA (EC) and Bank of Spain (BoS)**

The EC provided an update on the latest developments and progress of Phase 2 of the EU Digital Finance Platform project and the next steps. BoS described the participation and experience of Banco de España in the synthetic data pilot project led by the EC and the key conclusions and recommendations they reached through the project including: (i) the necessity for transversal departments from an institution to engage when creating synthetic data, (ii) the introduction of common templates for balance sheet and other data before the synthetization process, (iii) and ensuring a complete awareness of market participants when it comes to limitations arising to the use of synthetic data.

Discussion: Questions from EFIF members focused on how Banco de España addressed the privacy issues accounted when synthesising data and on striking the balance between preserving required anonymity and the value of the final extracted data. One jurisdiction shared their experience with creating synthetic data; challenges and limitations they accounted and expressed appreciation and support to the EC project to create a single EU level data hub that would be particularly beneficial for smaller jurisdictions. One jurisdiction shared their experience with augmented data and expressed interest in bilateral cooperation through the further steps of Phase 2 of the EU Digital Finance Platform project.

5. Case study: NFT project in the Spanish Innovation Hub

— **Presentation by CNMV (Spain)**

CNMV presented an NFT project received through the ES innovation hub relative to the tokenisation of rental income with the issuance of NFTs and the issuance of a native token with a variety of functionalities in the platform.

Discussion: EFIF members raised several clarification questions on the case, including rental incomes and its recipients, guarantee fund, tax aspects, registration of the contract and possibility to break it down and sell, standard haircut applied. Members shared their experiences and challenged in performing legal qualification of NFT cases and discussed the possible links between NFTs and

financial services regulations. CNMV reminded that in Spain there is no national regulation that would mandate CNMV the supervision of crypto assets, but CNMV has competences in supervision of advertising of crypto assets for investment purposes. Members supported the need to discuss such NFT related cases and share supervisory experiences.

6. IOSCO Report on Innovation Facilitators in Emerging Markets

— **Presentation by IOSCO**

IOSCO presented its report published in July 2022 focusing on global trends in relation to innovation facilitators and provided an overview of regulatory initiatives with some examples of the current practices in several markets. The presentation concluded with four recommendations put forward by IOSCO to assist emerging markets in developing initiatives related to innovation facilitators in their jurisdictions. The report confirmed that a regulatory response to financial innovation requires a balanced approach allowing to support potential opportunities of innovation while containing the risks to investors, the integrity of markets and the stability of the financial system.

Discussion: Considering the similarities between the IOSCO report and the ESA Joint Report on innovation facilitators, it would be important to continue cooperation and exploit synergies between ESAs and IOSCO work streams when updating the EFIF Report on innovation hubs and sandboxes.

7. RegTech

— **Presentation by Greenomy : Alexander Stevens (CEO)**

Alex presented Greenomy's RegTech solutions enabling facilitated reporting for corporates, credit institutions, and asset managers focusing on a one-stop reporting platform for EU Taxonomy, SFDR, NFRD/CSRD, EET, and potentially emerging ESG Standards. The platform allows asset managers to screen their portfolio's EU taxonomy alignment, creditors- to screen their loan book's EU taxonomy alignment and provides other tools to meet industry practical needs. The platform allows connecting data sources, merging and delivering a single report. Ultimately improved reporting contributes to improving sustainability of reporting companies. Alex also explained potential links with the ESAP project managed by ESMA.

— **Presentation by Regnology : Alexander Grimm (Senior Vice President), Buncak Saykam (Director Client Relationships), Tommy Lehnert (Senior Executive)**

The 3 presenters from Regnology explained the solutions the company offers to financial institutions for regulatory reporting including a platform for data collection, analytics and supervisory workflows, and explained how it increases efficiencies in the processes. Tommy discussed combining risk data with risk reporting and extracting the maximum value of data. He also mentioned challenges related to the lack of skills and finding talents. Alex and Buncak stressed rising expectations from the society, financial institutions, regulators that drive standardisation. They presented a real RegTech use case "run the bank and change the bank" highlighting client's outcomes: elimination of reporting redundancies (deliver once and use multiple times); reconciliation efforts (automation of calculations); reduction of manual work; making regulatory changes smooth for financial institutions.

Discussion: EFIF members agreed that the changing regulatory environment having as a goal to address emerging risks, embrace digitalisation and adapt to the changing realities of financial

services may pose additional challenges for market participants in terms of compliance and reporting that can create new business opportunities for RegTech companies. One member state was interested in how the RegTech companies address the lack or low quality of data issue and how they minimise inaccuracies. Greenomy developed rich metadata and implemented audit practices for 3rd party data providers to reduce such risks. Regnology stressed that additional regulatory requirements and validation points ultimately contribute to more robust outcomes over time. The discussants also stressed the benefit of further reconciling regulatory and business requirements and reaching better efficiencies in using data sets for different purposes (e.g. for regulators, shareholders, internal risk management).

8. Equifax

— **Presentation by Federico Sembolini (Innovation & Data Science Manager), Stuart Holland (Director of External Affairs)**

Stuart and Federico presented a project called NeuroDecision Technology that they had with the Spanish Sandbox. The aim of the project was to test the explainability features and improvements of a credit risk scoring model, based on machine learning algorithms. They compared the success rate of traditional models to an ML model with monotonic constraints and how the model meets the explainability and transparency requirements for AI. The key conclusion of the test is that the use of Machine Learning algorithms with monotonic constraints can represent an advantage for financial entities. The study showed that monotonic constraints gave the model more control of overfitting, regardless of the dataset. However overall, the accuracy of ML models significantly depends on the dataset, and that improvement over simpler AI models is often low.

Discussion: EFIF members raised questions about the data used for the test and how ML can improve financial inclusion and accuracy in credit scoring. There is a regulatory requirement for explainability of AI/ML models, so it is important to advance on the techniques enabling this explainability. Hence there is a clear trade-off between accuracy and financial inclusion, and interpretability. To the question from the EBA on the possibility to "export" the model to other types of consumers, the presenters explained that while predictive power may not be "exportable", the level of "explainability" could be easy to apply to other data sets. One member highlighted that while models are important, the value of the underlying data and its quality is crucial. The EBA also highlighted the "data minimisation principle" that should be respected when defining data sources and shaping the open finance framework.

9. NFT case studies

— **Presentation by Binance: Steven McWhirter (Director of Regulatory Policy), Hugo Coelho (Director, EU affairs); Stefan Piech (Research)**

The presenters from Binance introduced to the Forum the concept of NFTs, provided its technology and regulatory overview, including the intricacies of the fungibility criteria; explained NFTs uses, the process of making and selling NFTs, Binance NFT marketplace (with 5 top collections on Binance NFT market); concluded with analyses of the upcoming MiCA regulation, its links to NFTs and raised the question on the need of bespoke regime to address emerging risks.

— **Presentation by Ledger: Julien Nivot (Head of Regulatory Affairs)**

Julien presented to the EFIF Ledger's vision of NFTs focusing on cyber risks related to NFTs and security solutions offered by Ledger (Ledger Live and Vault as a safe and secure wallet to mint, drop, buy and sign with private keys). For 2023 Ledger plans to provide NFT support (i.e. enabling to see NFTs in wallet, send and receive NFTs, transactional signing) and connect to OpenSea, Rarible, ArtBlocks, POAP, FWB (3rd party platforms). Julien also described the Ledger NFT market and the type of services provided on this platform mentioning its own Ledger NFT– Genesis pass.

Discussion: EFIF members welcomed the opportunity to study NFT cases especially considering ongoing discussions on the role of financial regulators in addressing the risks posed by NFT markets. The EBA raised the question about intellectual property rights and the approach NFT markets take to improve the disclosure of IP rights. Binance confirmed that as a platform they are submitted and compliant with disclosure requirements including IP right disclosures. Another question raised concerned the institutional participation in NFT markets and services. Ledger's observation is that traditional financial intermediaries do not get into NFT markets. To question of one jurisdiction about the differences between NFTs on Ethereum vs NFTs on Binance blockchain, Binance responded that from technical perspective the differences are rather marginal. The discussion concluded with analysing appropriate regulatory tools to address risks related to NFTs (e.g. "blind signing" practices) and that consumer protection can be shaped only when there is a better understanding of the market, speculations and volatilities. Moreover, NFT is a broad term, and the risks depend on the type of NFT. The "best execution" rules of MiCA would be difficult to apply to NFTs. There is also a possibility of DORA being applied.

10. Closing remarks

ESMA closed the meeting by thanking all the members and contributors for their active participation, adding that the next meeting to be organised and chaired by the EBA is planned for February 2023.