Position Paper

Response to ESMA call for evidence on digital finance

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Insurance Europe welcomes the opportunity to share its views on the issues covered by the European Securities and Markets Authority (ESMA) call for evidence on digital finance: fragmentation and non-integration of value chains, digital platforms and the risks of mixed activity groups.

1. More fragmented or non-integrated value chains

What changes have you observed, if any, in value chains for financial services (eg more fragmented value chains) as a result of use of technological innovation by regulated entities or the entry of new market participants (Including technology companies providing financial services in the EU, either directly or through arrangements with financial entities)?

Cooperation/collaboration with partners has always been an important aspect of the insurance market: eg in the context of insurance intermediation. Developments in the digital environment as a result of the use of technological innovation have simply meant that the extent and diversity of collaboration has increased. Potential cooperation partners for insurers now range from other traditional (re)insurers/intermediaries and new fintech or insurtech companies focusing on different parts of the insurance value chain, to technology companies and partners from other industries (eg the automobile industry).

Examples of such collaboration include:

- Insurance distribution via comparison websites or digital ecosystems
- Cloud outsourcing
- Claims processing
- Collaborations in product design

This cooperation/collaboration brings many advantages, both for the insurer and the insured, as well as society as a whole. It contributes to making the insurance industry safer, more innovative, more agile and cost-efficient.

For individual insurers, strategy options have increased, with enhanced opportunities to focus on specific competitive advantages. For example, the incorporation of external expertise into the value chain has become easier and new niche strategies have become possible, promoting a broader field of providers along the insurance value chain.

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For policyholders, an important advantage of the increase in partnerships is easier and faster access to insurance products. This cooperation/collaboration is aimed at enhancing the range of products and services offered to consumers to better serve their interests and needs.

Do you see new/exacerbated risks (eg to consumer protection, financial stability, market integrity, security or level playing field) as a result?

With regard to possible risks, the European insurance sector is a well-regulated and supervised industry. Where new service providers enter the market, the regulatory framework offers effective protection as long as these entrants are subject to the principle of "same activities, same risks, same rules". The existing framework (Solvency II in particular) also covers outsourcing to third parties.

Over the longer term, however, and particularly in the case of critical or important functions, it will be important to have direct supervision of third parties, eg cloud service providers, as part of the overall regulatory framework, which is something the proposed Digital Operational Resilience Act (DORA) regulation is expected to introduce.

In some areas, eg cloud computing, the risks are likely to stem more from market concentration and potential dependencies than from increased fragmentation.

Do you have any recommendations for regulators/supervisors to address opportunities and challenges brought by changes in value chains?

Regulators and supervisors should aim to facilitate a greater reliance on independent assurance by third-party certification bodies to demonstrate compliance with relevant standards.

The European Insurance and Occupational Pensions Authority's (EIOPA) guidelines on cloud outsourcing are a positive step in this regard as they enable insurers to use third-party certifications and third-party or internal audit reports made available by the cloud service provider. This is without prejudice to their ultimate responsibility regarding the activities performed by their cloud service providers.

In terms of audit obligations vis-à-vis third-party providers, Insurance Europe would be supportive of allowing a system whereby these providers can obtain certification that verifies certain quality standards and compliance with current regulations. Providers that have been certified in such a way could also then be listed in a public register serving as an easy-to-access source of information. Service Organisation Control (SOC) reports could be used by regulators, for example, to provide evidence of compliance with relevant quality standards and/or regulations. Such reports are widely used within the industry and contain valuable information to assess and address the risks associated with an outsourced service. This would also allow for a more efficient use of audit resources.

Insurance Europe notes the work currently being carried out by the European Union Agency for Cybersecurity (ENISA) on cloud security certification in order to enhance legal certainty and trust in the cloud market. The development of such a certification scheme will facilitate cloud uptake by demonstrating the equivalence of security requirements throughout Europe and make it easier to compare cloud service providers with respect to security when considering switching provider. It will also help to overcome the current patchwork of cloud security certification schemes. This will be of central significance for the European data economy and the further digitalisation of the industry.

More generally, it should also be stressed that the market is characterised by continual development: ie any further changes are therefore not likely to be "one-off" but rather an on-going evolution. The relevant issue for regulators/supervisors to bear in mind is not only how to address and manage the short/medium term, but also how to ensure an appropriate framework that is compatible with the continuous evolution that can be expected in the future.

2. Digital platforms[1] and bundling of services

There are potentially a range of different types of platform: eg where a financial entity may be behind the infrastructure, where the financial entity simply avails of an existing platform, or platforms that may be cross-sectoral in nature. Depending on who is responsible for the operation of the platform, there may be different considerations: eg restrictions or conditions placed on how the platform can be accessed or issues of self-preference in the offering or ranking of products and services.

An important potential benefit of digital platforms is that they may offer new ways and channels to access insurance and can potentially contribute to reducing insurance gaps. The most significant risk, on the other hand, is the potential for market distortions if a true level playing field and fair competition are not ensured.

With regard to insurance distribution, the potential risk for customers is a lack of transparency and that platform providers do not provide clear information about their status (eg if they are agents or brokers) or that the demands and needs of customers are not sufficiently queried during the course of the process.

3. Risks of groups combining different activities

What is your view on BigTech groups, whose core business is not financial services but that have subsidiary undertakings (or partners, related entities) that provide financial services? Specifically thinking about their place within or outside of the regulatory perimeter.

The European insurance sector is a comprehensively regulated and supervised sector with a sound conduct of business and prudential framework in place. However, while new technological opportunities and new customer behaviour enable new service concepts, new service providers (eg BigTech) have also entered the market. Maintaining a true level playing field between insurers and BigTech players, while avoiding regulatory arbitrage at European level, will therefore be crucial.

It is crucial that new service providers, such as large BigTech companies, that enter the insurance market are subject to the insurance regulatory framework. This may be self-evident where they specifically engage in the distribution of insurance products to consumers, for example, but may prove more challenging where they are focused only on limited parts of the value chain.

The focus should be on ensuring that the regulatory framework in the insurance sector continues to be activity-based and follow the principle of "same activities, same risks, same rules". This would help to ensure that even where their business activity focuses only on a specific part of the value chain, it is subject to the same rules as all other companies performing the same activity.

What risks do you see in this context (data privacy, AML, consumer/investor protection, other)? Are these risks systemic? (e.g., due to the nature of the risk or size of the group)

Ensuring a level playing field between different market players and avoiding different rules between providers should be a key focus, both from a data protection/privacy and consumer protection perspective, and from a general financial stability perspective. Policymakers must also ensure that financial customers enjoy the same level of protection, regardless of whether they are served by established providers or new entrants to the market, by bringing all new market entrants within the scope of all relevant legislation.

[1] 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.

BigTech companies generate and collect vast amounts of non-financial data inherent to their business model – this could allow them to develop unfair competitive advantages over incumbent insurance undertakings by combining financial data with non-financial user data to profile consumers: eg from social media platforms. If BigTech firms are allowed to utilise this much broader understanding of consumers and businesses compared to insurers, driven by their much more frequent interactions with consumers and their ability to tailor products and prices based on behavioural data, they could leave incumbents at an unfair competitive disadvantage. This could allow BigTech firms to further consolidate their already dominant positions in the data market and further gain market share in financial services.

One of the key challenges for the future will be to ensure fair competition between market players and business models. The most significant expected risk associated with BigTech companies gaining substantial market share in financial services relates to competition issues and potential abuses of market power. BigTech companies may make use of their market power when entering into partnerships or commercial agreements with certain financial service providers or provide them with favourable conditions to the detriment of their competitors. This could result in restricting access to certain services by other financial service providers, or imposing unfair terms and conditions, such as requiring payments to be made only via the BigTech company's own platform.

What do you see as the main barriers to a level playing field between BigTechs and 'traditional' financial entities?

Maintaining a level playing field between European financial services companies and BigTech is a key issue, particularly in terms of access to data and data monopolies. In the context of barriers to achieving this, insurers see possible limitations and restrictions in the insurance sector for undertakings wishing to implement innovative digital strategies. Under the Solvency II regulatory framework, for example, some new digital activities might be classified as "non-insurance business". Consequently, they would not be permissible for insurance companies. This is counter to the level playing field principle, as it puts insurance companies at an unjustified disadvantage relative to other participants in the digital economy. Therefore, the current definition of "insurance business" should be reconsidered in a way that the new cooperation and digitally related activities of insurers are encouraged and will be considered as an integral part of their core insurance business.

In this regard, Insurance Europe would highlight recommendation 24 of the European Commission's Expert Group on Regulatory Obstacles to Financial Innovation (ROFIEG), which states that the impact of existing activities' restrictions for financial institutions' non-core business (eg Article 18 of Solvency II) should be reviewed to determine whether these restrictions remain proportionate. According to the expert group, this review should pay particular attention to cross-sectoral considerations, to ensure a level playing field between different types of players in the financial sector, including BigTech.

Ensuring the principle of "same activities, same risks, same rules" is clearly key to a level playing field. Data reciprocity is also something that is cited as an important factor to ensure that different players act on an equal footing and to ensure fair and equal access to data. However, it is important to note that there are clear challenges associated with using data reciprocity as a mitigating concept vis-à-vis BigTechs, as the data that different parties hold and are allowed to share is often not comparable, or even incompatible with the different actors' business models.

For example, with regard to the respective business models, most financial institutions are incapable of generating value from the data in the same manner as BigTech (ie monetising behavioural data to make money via advertising), which leaves financial institutions at a disadvantage. However, BigTech may gain a much larger value from verifiable personal data that is obtained from financial institutions. It is therefore crucial to respect the principle of "same activities, same risks, same rules" and strive for a true level playing field.

What is your view on the current regulatory framework for such mixed activity groups: do you believe platforms that operate across multiple Member States to market or provide various financial products and services are effectively regulated and supervised or do you consider there is a need to extend, modify current EU financial services regulation or have a new framework for the regulation and supervision of such groups on a holistic basis potentially with other authorities like data /competition?

As already explained, the principles of "same activities, same risks, same rules" and a level playing field are key, as well as making necessary adaptations to the Solvency II framework to ensure that insurance undertakings are not unduly restricted in their ability to compete with such entities.

In a more general sense, there is currently a lack of collaboration between national competent authorities (NCAs) in the digital/innovation space. It will be important moving forward, particularly when considering mixed activity groups, that the respective regulators for conduct of business, prudential, competition and data protection collaborate and work more closely together to help further develop the digital single market for financial services. Without close collaboration between NCAs, the EU runs the risk that any regulatory framework for digital finance is interpreted differently across member states, and certain entities are not subject to the same levels of supervision and regulation, leading to further fragmentation of the market.