

19 March 2020

ECSDA RESPONSE TO THE EUROPEAN COMMISSION CONSULTATION ON CRYPTO-ASSETS

Summary of ECSDA views

The European Central Securities Depositories Association (ECSDA) welcomes this initiative of the European Commission (EC) and wishes to share the views of Central Securities Depositories (CSDs) on this consultation. CSDs share many of the views of the European Commission expressed in the consultation. Our consultation response focusses mainly on tokens other than stablecoins.

In addition to the answers to the consultation questions, ECSDA's main considerations regarding the consultation are the following:

- 1) **CSDs innovate, including using DLT.** ECSDA members have been constantly working on increasing efficiency and finding innovative solutions, while complying with the EU legislation and in constant dialogue with the market stakeholders. Many CSDs are working on innovation projects, including DLT-based solutions, and some are already using DLT as part of their core system or ancillary services in production. CSDs aim at supporting any business models and mature technology that may contribute to an efficient and safe market infrastructure for any type of assets.
- 2) **Current EU legislation (like CSDR, SFD and FCD) is technology-neutral and fit for purpose for investment tokens.** It was built for achieving the goal of investor protection and mitigation of systemic risks, not to support a specific technology. It provides for key safeguards enabling stakeholders, such as issuers, intermediaries and other service providers, to operate in a clear environment with limited risk. These safeguards are relevant for servicing any type of assets, disregarding the underlying technology used. Hence, we share the perspective expressed in the consultation that any future legislation should also be technology-neutral.
- 3) **Incorporating crypto-assets not falling under the current regulation into the existing financial regulatory framework, where appropriate, will inject trust and legal certainty, enable their quick adoption, address financial stability, consumer protection and market integrity needs.** In the cases where this would not be

appropriate (e.g. stablecoins) and, hence, where there may be a bespoke regime (involving a different regulatory framework and/or approach of the authorities), stakeholders, in particular issuers and investors, will gain by being serviced by a trusted entity. It might be considered whether the Principles for Financial Market Infrastructures would provide the right basis for its regulation.

CSDs role in financial markets, includes that of standard-setters and guarantors of stability in relation to post-trade aspects, the possible creation of a bespoke regime should take that role into consideration. It should include CSDs operators as relevant actors, and should not create additional regulatory barriers for the provision of services, whether servicing instruments falling under the existent framework or using allowing stablecoins to pay on the delivery of investment tokens.

Guiding principles for a crypto-asset legal framework in further detail

In our response below, we highlight the guiding principles that, in our view, will be helpful to the legislators while embracing the new technology in a safe way.

A. Crypto-assets classification should apply a substance over form approach

We agree with the EC approach considering that the European legislation applicable to an asset should be determined by the asset's inherent concrete economic characteristics.

Despite the relevant previously existing forms of financial assets, as physical, immobilised or dematerialised securities, the European legislation of the different service providers and markets was not focused on their form, but rather on their substance and the mitigation of related risks. In that vein, the inscription of financial instruments as crypto-assets based on DLT is a matter of form, not of substance. ESMA and EBA have also previously highlighted their support of such “substance over form” approach: i.e. if investment tokens have the same characteristics as MiFID financial instruments, these should require the application to them of the relevant existing regulation, such as detailed in the ESMA Advice¹ on ICOs and Crypto-assets. We, therefore, also support the views expressed in the EC consultation adopting this approach.

In some practical cases, we have noticed the creation of hybrid or new types of investment tokens that would have only slight differences of characteristics from MiFID instruments. We believe it is important that securities regulators pay

¹ ESMA, Advice on ICOs and Crypto-assets, 9 January 2019, ESMA50-157-1391, p.20.

attention to such cases that may lead to circumventing the application of the relevant regulation and, hence, regulatory arbitrage.

B. For security tokens, existing securities legislation should be applied, and its underlying principles should be respected

Assets that have the same characteristics as MiFID financial instruments should be classified as security tokens, for the existing framework is – to a large extent – fit for purpose.

We believe that the existing EU securities legislation framework, including CSDR and SFD, is fit for purpose and does not require structural changes but rather clarifications. Further clarity in the current EU legislation may be relevant, for example to say that accounting certainty, auditability and data protection (requirements related to segregation of accounts and reconciliation) may be achieved in a different way than what is currently in practice.

There are already cases of use of DLT technology by authorised CSDs and we believe that the legislation is sufficiently neutral to allow its further use. Existing regulation provides for safeguards that do not prevent the use of DLT, rather they ensure its safe use. In this context, we recall that the requirements of these regulations are justified by the primary objective to ensure financial stability.

Below, we mention some of these features and provide ECSDA’s view to show that the legislative concepts in existing legislation are fit for purpose:

I. CSDR

- **Recording on an account in a book-entry form and definition of securities accounts.** CSDR does not prescribe any technical execution method for the registration of securities. At the same time, the notion of a ‘securities account’ is defined in CSDR in a broad way, i.e. "an account on which securities can be credited or debited". It is our view that this definition could encompass recording on a permissioned DLT account. Hence, the only possible questions on the matter may arise at national level, as the recognition of ownership and other entitlement in securities transferred through registration in account is governed by domestic legislation. This clarification has already been made in some countries, e.g. in France, recording on DLT was clarified as having equivalent effects to the book-entry on an account.
- **Requirement to settle transactions on a Delivery-versus-Payment (DvP) basis** (Article 39.7). The fundamental need for DvP is to remove the settlement risk between market participants. Hence, whenever the transaction is against cash, but not using a DvP mechanism, it would leave market participants exposed to possibly

substantial risk. Therefore, any technology used for transferring securities or other investments should offer an interface or link to the relevant payment solution to maintain the same level of risk mitigation.

II. SFD

- **Participants restricted access to SSS (Article 2f).** In this context, we note the encouragement of the CSDR of a broad participation in CSDs. At the same time, in terms of split of roles, there should be a party in the system to ensure that the necessary retail-user-related interactions and verifications are performed, such as for example Anti-Money Laundering and Counter-Terrorist Financing (AML/ CTF) and Know Your Customer (KYC) obligations.
- **Obligation to identify an operator of the DLT network acting as a SSS.** There is a need for accountability and legal certainty of securities transfers. This is also essential for the management of settlement instructions in the case of insolvency of a participant. It should be clear to users and regulators who is accountable for eventual issues related to the functioning of the processes and compliance with legislation.

Finally, the cost of compliance with the regulation (CSDR, SFD, FCD and other) cannot be considered as a barrier as these costs are arising for the current CSD operators as they would be for the companies willing to start providing CSD services in the future, independently from the technology that is or will be used by them.

C. If a separate bespoke regime would be needed, it should be technology-neutral, follow clear taxonomy and fundamental principles.

For investment or utility tokens not yet considered in the current regulation, the primary objectives of policymakers shall be to ensure financial stability and investor protection. These elements are as relevant, as technology *per se* cannot ensure them.

Where, additional rules are deemed necessary for crypto-assets (e.g. for stablecoins), these rules should ensure:

- Technological neutrality,
- Clear classification/taxonomy and
- Regulatory coherence (i.e. that they follow same fundamental principles as other assets).

If this legislative direction is chosen by the policy-makers, the service providers should be able to respond to the existent fundamental regulatory needs and principles, such as:

- Ensuring the integrity of the issue,
- Clarity on the applicable law,
- Clarity on who takes the accountability for operational, settlement and other risks,
- Clarity on the settlement finality,
- Auditability and data protection,
- Ensuring AML/CTF and KYC obligations.

These and other requirements listed under Principles for Financial Market Infrastructures provide the global policymakers perspective on how to ensure an adequate level of investor protection, cater for financial stability concerns and market efficiency needs.

If a separate bespoke regime would be needed, it should also provide for clear accountability. As we have mentioned, the existing regulatory framework can cater for the needs of crypto- assets (with some exceptions, e.g. for stablecoins, which are not yet covered).

This is especially relevant because the risks noted by IOSCO² that could arise where a Crypto-assets Trading Platform (CTP) offers custody include the following:

- Operational failure;
- Theft, loss or inaccessibility of private keys;
- Comingling of assets;
- Inaccurate record-keeping; and
- Insufficient assets to meet liabilities.

Furthermore, IOSCO found that there may be concerns about the procedures that the CTP may have in place in the event of loss of participant assets. **We encourage the EC to perform a comprehensive risk assessment to clearly define in the special bespoke regime the risks to be catered for. As the technology cannot be regulated or held liable as such and, it is fundamental that there is a regulated legal entity that can be held accountable.**

D. We encourage policymakers to use the legislative momentum for providing more legal clarity for crypto assets

The discussion on classification of tokens is currently very relevant. We hence support the view that it is the right moment to express regulatory guidance on the

² IOSCO, *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms Final Report*, February 2020, p. 13. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD649.pdf>

classification and a possible new bespoke regulatory regime for certain types of tokens.

The classification of a token as an investment token or as another type of instrument would then define if it should follow the existing securities or payments regulation (MiFID, CSDR etc.) or rather a bespoke regulation.

Market infrastructures, including CSDs, should be able to service these assets, without being required to do that from another legal entity; and, hence, without fragmenting the market segments that would benefit of being combined for the needs of bigger collateral pool capacity, higher capital raising opportunities for issuers and broader investment diversification possibilities for investors.

About ECSDA

ECSDA stands for the European Central Securities Depositories Association and represents 41 Central Securities Depositories (CSDs) across Europe and beyond. CSDs are financial market infrastructures which are intrinsic to the operation of Europe's financial markets, constantly striving towards a more secure and efficient financial marketplace. Offering a set of core and ancillary services defined in the EU CSD Regulation, European CSDs provide a risk-averse environment for recording, settlement, and custody of securities across Europe and beyond.

ECSDA response to the detailed questions of the consultation

Part II. Classification

Question 5.

Do you agree that the scope of this initiative should be limited to crypto-assets (and not be extended to digital assets in general)?

We believe that any taxonomy adopted by European legislators cannot have as reference the usage of a certain technology feature to identify a new type of asset. The definition should rather refer to the inherent characteristics of asset and of its market. For instance, looking at financial market regulation, the definition should look at the financial characteristics of each type of asset in order to classify it as a financial instrument or, more broadly, as an investment product.

Question 6.

In your view, would it be useful to create a classification of crypto-assets at EU level? If you think it would be useful to create a classification of crypto-assets at EU level, please indicate the best way to achieve this classification (non-legislative guidance, regulatory classification, a combination of both, ...).

It is important to clearly indicate the category under which the tokens are falling, as it would point to the regulation it should be subject to. The criteria need to be clarified further as we believe that some of the hybrid, utility or e-money tokens could be rather seen as investment tokens. Clear rules on classification should be provided. The issuer of crypto-assets should use the guidance on the classification to decide what type of token it issues, and hence which legislative framework should apply. Such decision should be made public. Market authorities should be able to challenge the issuer choice.

Question 7.

What would be the features of such a classification? When providing your answer, please indicate the classification of crypto-assets and the definitions of each type of crypto-assets in use in your jurisdiction (if applicable).

We are of the view that the European Legislation applicable to an asset should be determined by the asset's concrete characteristics. In short, assets with the same characteristics, posing similar risks, should fall under the same principles and should follow the same rules. The existing regulatory framework applicable to the current known types of financial assets is not focused on their form, but rather on their substance and protection of inherent risks. In our view, the inscription of an asset financial instrument on a DLT is a matter of form, not its substance, and, therefore, the current approach does not need to be changed.

ESMA and EBA have also previously highlighted their support of such “substance over form” approach. If investment tokens have the same characteristics, as MiFID financial instruments, then the relevant existing regulation should be applicable, such as detailed in the ESMA Advice on ICOs and Crypto-assets and mentioned in the present consultation.

In some cases, we have noticed the creation of hybrid or new types of investment tokens that would have only slightly different characteristics with regard to MiFID instruments. We believe that it is important that securities regulators pay attention to these cases, that may lead to circumventing the application of the relevant regulation.

Question 8.

Do you agree that any EU classification of crypto-assets should make a distinction between ‘payment tokens’, ‘investment tokens’, ‘utility tokens’ and ‘hybrid tokens’? If you do agree that any EU classification of crypto-assets should make a distinction between ‘payment tokens’, ‘investment tokens’, ‘utility tokens’ and ‘hybrid tokens’, please indicate if any further subclassification would be necessary.

Yes, we agree that any EU classification of crypto-assets should make a distinction between ‘payment tokens’, ‘investment tokens’, ‘utility tokens’ and ‘hybrid tokens’.

Part. III Crypto-assets not covered by EU legislation

Question 10.

In your opinion, what is the importance of each of the potential benefits related to crypto-assets listed below? (Please rate from 1 “not important at all” to 5 “very important”)

- a. Issuance of utility tokens as a cheaper, more efficient capital raising tool than IPOs 5
- b. Issuance of utility tokens as an alternative funding source for start-ups 5
- c. Cheap, fast and swift payment instrument 5
- d. Enhanced financial inclusion 5
- e. Crypto-assets as a new investment opportunity for investors 5
- f. Improved transparency and traceability of transactions 5
- g. Enhanced innovation and competition 5
- h. Improved liquidity and tradability of tokenised ‘assets’ 5
- i. Enhanced operational resilience (including cyber resilience) 5
- j. Security and management of personal data 5
- k. Possibility of using tokenisation to coordinate social innovation or decentralised governance 5

Is there any other potential benefit related to crypto-assets not mentioned above that you would foresee? Please specify which one(s) and explain your reasoning.

The success and the benefits that are mentioned above are theoretical. They require a framework around crypto-assets that caters for adequate investor protection, market integrity, etc. We should bear in mind that crypto-assets can be mis-used, particularly if not adequately regulated, in which case none of the above benefits will occur.

We foresee the following other possible benefits, carried by a DLT-based solution:

- 1) Possibility for efficient cross-jurisdictional collateral management
- 2) Higher transparency on the voting processes

Question 11.

In your opinion, what are the most important risks related to crypto-assets? (Please rate from 1 “not important at all” to 5 “very important”)

- a. Fraudulent activities 5
- b. Market integrity (e.g. price, volume manipulation, ...) 5
- c. Investor/consumer protection 5
- d. Anti-money laundering and CFT issues 5
- e. Data protection issues 3
- f. Competition issues 4
- g. Cyber security and operational risks 5
- h. Taxation issues 3
- i. Energy consumption entailed in crypto-asset activities 4
- j. Financial stability 5
- k. Monetary sovereignty/monetary policy transmission 5

Is there any other important risk related to crypto-assets not mentioned above that you would foresee? Please specify which one(s) and explain your reasoning.

Some important risks are not mentioned: custody risk (risk of loss of assets), settlement risk (payment of the asset before receiving it), legal risk (lack of clear accountability/liability).

We foresee the following other risks:

- Regulatory arbitrage with the traditional instruments, if there is no clarity on the taxonomy
- Market fragmentation

Above all, we would like to highlight the potential of crypto-assets to impact financial stability, which is already mentioned in the list.

Besides **'classic' risks** of new asset-classes (fraud, money laundering, market manipulation ...), **technology related 'new' risks** arise (energy consumption, finality, integrity of the network, 'forks', 'whales', 'right to be forgotten' in Art 17 GDPR not easy to apply...)

Some DLT forms, such as public blockchains having **no legally accountable entity** to be held liable for failing to implement risk management procedures to address the risks mentioned above, may cause a **risk by itself due to the absence of accountability**. We would recommend policies and procedures to be followed by entities that wish to offer their products and services to "retail clients" or offer securities to the public.

There are **specific risks arising from smart contracts**, e.g. in the case of unintended programming of the algorithm within such a smart contract. **A trusted third party** would help to prevent or mitigate such risks from occurring, e.g. by providing certified smart contracts and ensuring their execution.

So-called smart contracts should ideally follow a general standard and be certified. Such standards could be set at the EU level but should be aligned with international bodies and developed with market participants.

We would urge to make a more comprehensive risk analysis.

Question 16.

In your view, how would it be possible to ensure that a bespoke regime for crypto-assets and crypto-asset service providers is proportionate to induce innovation, while protecting users of crypto-assets? Please indicate if such a bespoke regime should include the above-mentioned categories (payment, investment and utility tokens) or exclude some of them, given their specific features (e.g. utility tokens)

If a separate bespoke regime would be needed, it should be technology neutral, follow clear taxonomy and fundamental principles.

For investment or utility tokens not yet explicitly covered by the current regulation, the primary objectives of policy-makers to ensure financial stability and investor protection are as relevant, as technology per se cannot ensure them; and many of the principles in the current regulation are also relevant.

Where additional rules are deemed necessary for crypto-assets (e.g. for stablecoins), these rules should ensure:

- Technological neutrality,
- Clear classification/taxonomy

- Regulatory coherence (i.e. that they follow same fundamental principles as other assets).

If policymakers decide to follow a legislative path, the service providers should be able to respond to the existent fundamental regulatory needs and principles, such as:

- Ensuring the integrity of the issue,
- Clarity on the applicable law,
- Clarity on who takes the accountability for operational, settlement and other risks,
- Clarity on the settlement finality,
- Auditability and data protection,
- Ensuring AML/CTF and KYC obligations.

These and other requirements listed under Principles for Financial Market Infrastructures provide global policymakers a perspective on how to ensure an adequate level of investor protection, cater for financial stability concerns and market efficiency needs.

If a separate bespoke regime would be needed, it should also provide for clear accountability. As mentioned, the existing regulatory framework can cater for the needs of crypto- assets (with some exceptions, e.g. for stablecoins, which are not yet covered).

This is especially relevant because the risks noted by IOSCO³ that could arise where a Crypto-assets Trading Platform (CTP) offers custody include the following:

- Operational failure;
- Theft, loss or inaccessibility of private keys;
- Comingling of assets;
- Inaccurate record-keeping; and
- Insufficient assets to meet liabilities.

Furthermore, IOSCO found that there may be concerns about the procedures that the CTP may have in place in the event of loss of participant assets. **We encourage the EC to perform a comprehensive risk assessment to clearly define the risks to be catered for in a special bespoke regime. As the technology cannot be regulated or held liable as such and, it is fundamental that there is a regulated legal entity that can be held accountable.**

Question 17.

Do you think that the use of crypto-assets in the EU would be facilitated by greater clarity as to the prudential treatment of financial institutions' exposures to crypto-assets?

- Yes
- No
- Don't know/no opinion

Please indicate how this clarity should be provided (guidance, EU legislation...).

³ IOSCO, *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms Final Report*, February 2020, p. 13. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD649.pdf>

Yes, guidance providing further clarity on the prudential treatment would be helpful. For the reasons of global convergence, we would ask for it to be provided by the global standard setting bodies.

Question 33.

Should custodial wallet providers be authorised to ensure the custody of all crypto-assets, including those that qualify as financial instruments under MiFID II (the so-called ‘security tokens’, see section IV of the public consultation) and those currently falling outside the scope of EU legislation?

- Yes
- No
- Don't know/no opinion

Please explain your reasoning (if needed).

Yes, provided that custodial wallet providers are compliant with all applicable rules as regards the custody of financial instruments. In any case, CSDs and custody banks holding financial instruments should be allowed to also hold crypto-assets.

Part IV. Crypto-assets that are currently covered by EU legislation

Question 54.

Please highlight any recent market developments (such as issuance of security tokens, development or registration of trading venues for security tokens, ...) as regards security tokens (at EU or national level)?

We would like to make reference to the AMI-SeCo FinTech ongoing mapping exercise, the outcome of which should be published.

Question 55.

Do you think that DLT could be used to introduce efficiencies or other benefits in the trading, post-trade or asset management areas? Please indicate the specific areas where, in your opinion, the technology could afford most efficiencies when compared to the legacy system.

Yes, and a few CSDs already use DLT as part of the internal CSD core system. For relatively small volumes, the solution can be rolled out in a way that limits the reconciliation needs and hence provides the efficiency. Most technology providers consider the real-time settlement of decentralised solutions as one of the main benefits of DLT, which is an incorrect

assumption in our views. The currently used non-DLT systems can already settle securities in real time. They can do so with very high volumes. It is however the market decision to settle securities on the currently agreed settlement cycle of two days after the trade (T+2), which can be changed as soon as the market is ready. Currently, our assessment is that the market would not favour a reduced settlement cycle. We also note that the level of market efficiency, even for T+2 cycle, not yet at 100%. Shortening the cycle could result in lesser netting possibilities, that would require higher needs in liquidity and, otherwise, introduce a higher number of settlement penalties. Shortening the cycle, linked with the lesser netting possibilities, would significantly increase the bilateral counterparty risk. The overall cost related to transaction processing would then significantly increase. Hence, markets (including crypto) shall carefully reflect on the appropriate settlement cycle and the relevance of decentralised solutions for core settlement. DLT can be validly explored in the spheres where no (or less) netting is needed and shorter processing time could be relevant.

Question 56.

Do you think that the use of DLT for the trading and post-trading of financial instruments poses more financial stability risks when compared to the traditional trading and post-trade architecture?

Yes, unless:

- 1) The underlying principles of the current legislation apply,
- 2) Necessary regulatory clarifications are provided ahead of the use of DLT in production,
- 3) Only the mature technology is being used.

Question 57.

Do you consider that DLT will significantly impact the role and operation of trading venues and post-trade financial market infrastructures (CCPs, CSDs) in the future (5/10 years' time)? Please explain your reasoning.

Even if the DLT provides for de-centralisation, in a highly regulated environment gatekeepers and operators must be in place to safeguard the financial markets, a full outsourcing of regulatory duties to a system without clear responsibilities endangers the capital markets. Also, financial intermediaries play a useful role in administrating and managing assets for investors. Considering the financial crisis, CCPs and CSDs have proven to add significant stability to the markets. Accordingly, we foresee an even more important role for CCPs and CSDs to ensure trust in such a new technology. Certainly, operations and systems may greatly benefit from DLT. **Market infrastructures, including CSDs, should be able to service these assets, without being required to do that from another legal entity;** hence, without fragmenting the market segments that would benefit of being combined for the needs of

bigger collateral pool capacity, higher capital raising opportunities for issuers and broader investment diversification possibilities for investors.

Question 58.

Do you agree that a gradual regulatory approach in the areas of trading, post-trading and asset management concerning security tokens (e.g. provide regulatory guidance or legal clarification first regarding permissioned centralised solutions) would be appropriate?

Many of the concepts for the new asset types would be as relevant for the new type of securities as they are for the MiFID instruments, with no substantial adjustments. Caring about the primary policy objective of ensuring the stability of financial markets, only the sufficiently mature technologies should be considered in the scope of the legislation.

The classification of a token as an investment token or as another type of instrument would define if it should follow the existing securities regulation (MiFID, CSDR etc.) or rather a bespoke regulation.

CSDR

Question 88.

Would you see any particular issue (legal, operational, technical) with applying the following definitions in a DLT environment? Please rate from 1 (not a concern) to 5 (strong concern)

- a. Definition of 'central securities depository' and whether platforms can be authorised as a CSD operating a securities settlement system which is designated under the SFD 1
- b. Definition of 'securities settlement system' and whether a DLT platform can be qualified as securities settlement system under the SFD 1
- c. Whether records on a DLT platform can be qualified as securities accounts and what can be qualified as credits and debits to such an account 5
- d. Definition of 'book-entry form' and 'dematerialised form 1
- e. Definition of settlement (meaning the completion of a securities transaction where it is concluded with the aim of discharging the obligations of the parties to that transaction through the transfer of cash or securities, or both); 1
- f. What could constitute delivery versus payment in a DLT network, considering that the cash leg is not processed in the network 5
- g. What entity could qualify as a settlement internaliser 4

Question 89.

Do you consider that the book-entry requirements under CSDR are compatible with security token?

Yes, CSDR does not prescribe any technical execution method for the registration of securities and at the same time, the notion of a ‘securities account’ is defined in CSDR in a broad way, i.e. “an account on which securities can be credited or debited”. It is our view that this definition could encompass recording on a permissioned DLT account. If questions about legal certainty and “compatibility” arise at national level as the recognition of ownership and other entitlement in securities transferred through registration in account is governed by domestic legislation, the national legislator could consider clarifying it (e.g. in France, recording on DLT was clarified as having equivalent effects to the book-entry on an account).

Question 90.

Do you consider that national law (e.g. requirement for the transfer of ownership) or existing market practice in your jurisdiction would facilitate or otherwise prevent the use of DLT solution? Please explain your reasoning.

Please refer to Q.89

Question 91.

Would you see any particular issue (legal, operational, technical) with applying the current rules in a DLT environment? Please rate from 1 (not a concern) to 5 (strong concern)

- a. Rules on settlement periods for the settlement of certain types of financial instruments in a securities settlement system 1
- b. Rules on measures to prevent settlement fails 1
- c. Organisational requirements for CSDs 1
- d. Rules on outsourcing of services or activities to a third party 2
- e. Rules on communication procedures with market participants and other market infrastructures 1
- f. Rules on the protection of securities of participants and those of their clients 2
- g. Rules regarding the integrity of the issue and appropriate reconciliation measures 2
- h. Rules on cash settlement 2
- i. Rules on requirements for participation 1
- j. Rules on requirements for CSD links 2
- k. Rules on access between CSDs and access between a CSD and another market infrastructure 3

No, although these requirements need to be clarified on the way they could be met.

In particular, as regards rules on cash settlement, we believe that the following requirements are not barriers to the use of DLT:

- **Recording on an account in a book-entry form and definition of securities accounts.** CSDR does not prescribe any technical execution method for the registration of securities. At the same time, the notion of a ‘securities account’ is defined in CSDR in a broad way, i.e. “an account on which securities can be credited or debited”. It is our view that this definition could encompass recording on a permissioned DLT account. Hence, the only possible questions on the matter may arise at national level as the recognition of ownership and other entitlement in securities transferred through registration in account is governed by domestic legislation. This clarification has already been made in some countries, e.g. in France, recording on DLT was clarified as having equivalent effects to the book-entry on an account.
- **Requirement to settle transactions on a Delivery-versus-Payment (DvP) basis** (Article 39.7). The fundamental need for DvP is to remove the settlement risk between market participants. Hence, whenever the transaction is against cash, but not using a DvP mechanism, it would leave market participants exposed to possibly substantial risk. Therefore, any technology used for transferring securities of other investments should offer an interface or link to the relevant payment solution to maintain the same level of risk mitigation.

However, further clarity in the current EU legislation may be relevant, for example to say that accounting certainty, auditability and data protection (requirements related to segregation of accounts and reconciliation) may be achieved in a different way in comparison with the current practice.

SETTLEMENT FINALITY

Question 93.

Would you see any particular issue (legal, operational, technical) with applying the following definitions in the SFD or its transpositions into national law in a DLT environment?

- a. Definition of a securities settlement system
- b. Definition of system operator
- c. Definition of participant
- d. Definition of institution
- e. Definition of transfer order
- f. What could constitute a settlement account

- g. What could constitute collateral security

No, although it would be beneficial to have clarity by policy-makers on how the concepts apply in the DLT context. Previously we have seen that the following points were raised with regard to the compatibility of DLT with the SFD. However, these do not represent a barrier in our view for the reasons outlined below:

- **Participants restricted access to SSS (Article 2f).** In this context, we note the encouragement of the CSDR of a broad participation in CSDs. At the same time, in terms of split of roles, there should be a party in the system to ensure that the necessary retail-user-related interactions and verifications are performed, such as for example Anti-Money Laundering and Counter-Terrorist Financing (AML CTF) and Know Your Customer (KYC) obligations.
- **Obligation to identify an operator of the DLT network acting as an SSS.** There is a need for accountability and legal certainty of securities transfers. It is also essential for the management of settlement instructions in the case of insolvency of a participant. It should be clear to users and regulators who is accountable for eventual issues related to the functioning of the processes and compliance with legislation.

In this context, we recall that the requirements of these regulations are justified by the primary objective to ensure financial stability and reduction of systemic risk.

Finally, the cost of compliance with the regulation (CSDR, SFD, FCD and other) cannot be considered as a barrier as they are as problematic for the current CSD operators as they would be for the companies willing to start providing CSD services in the future, independently from the technology that is or will be used by them.

The definition of ‘system’ is sufficiently flexible as it covers contractual arrangements and not technical systems. Current provisions of SFD already cater for some activity in the domain of digital- assets, however, attention shall be given in a future review to aspects such as their explicit inclusion in the definition of ‘transfer orders’. However, the definition of ‘transfer order’ would need to cover all relevant digital-assets including crypto-currencies to cater for finality of relevant instructions.

A system operator must be responsible for the relevant ‘systems’ and ‘transfer orders’. Consequently, with regard to DLT-solutions, those with private permissioned blockchain are most viable, even if public permissioned solutions are also conceivable. Regulators should ensure that requirements of CSDR and SFD are not circumvented by DLT.

Question 94.

SFD sets out rules on conflicts of laws. According to you, would there be a need for clarification when applying these rules in a DLT network (in particular with regard to the

question according to which criteria the location of the register or account should be determined and thus which Member State would be considered the Member State in which the register or account, where the relevant entries are made, is maintained)? Please explain your reasoning.

Yes, we would appreciate such clarity. The location of an asset constituted on a DLT and the possible span of a DLT over several jurisdiction, could prevent us from using current conflict of laws solutions. Hence, we would appreciate further clarity, that may need to be agreed at the international level.

Question 96.

Do you consider that the effective functioning and/or use of DLT solution is limited or constrained by any of the SFD provisions? If you do agree that the effective functioning and/or use of DLT solution is limited or constrained by any of the SFD provisions, please provide specific examples (e.g. provisions national legislation transposing or implementing SFD, supervisory practices, interpretation, application,). Please explain your reasoning.

We perceive that this is not the case. CSDs have sufficient clarity and believe that SFD provides sufficient certainty.

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Question 97.

Would you see any particular issue (legal, operational, technical) with applying the following definitions in the FCD or its transpositions into national law in a DLT environment?

- a. If crypto-assets qualify as assets that can be subject to financial collateral arrangements as defined in the FCD
- b. If crypto-assets qualify as book-entry securities collateral
- c. If records on a DLT qualify as relevant account.

Although we do not perceive any fundamental constraint in the use of DLT resulting from the FCD, we would appreciate further legal clarity on these concepts in the DLT context.

Question 98.

FCD sets out rules on conflict of laws. Would you see any particular issue with applying these rules in a DLT network?

In line with our comments on SFD (*see answer to question 94*), we would appreciate additional clarity.

Question 100.

Do you consider that the effective functioning and/or use of DLT solution is limited or constrained by any of the FCD provisions? If you do agree that the effective functioning and/or use of a DLT solution is limited or constrained by any of the FCD provisions, please provide specific examples (e.g. provisions national legislation transposing or implementing FCD, supervisory practices, interpretation, application, ...). Please explain your reasoning.

No

OTHER QUESTIONS ON TOKENS

Question 108.

Do you think that the EU legislation should provide for more regulatory flexibility for stakeholders to develop trading and post-trading solutions using for example permission less blockchain and decentralized platforms? If you do think that the EU legislation should provide for more regulatory flexibility for stakeholders to develop trading and post-trading solutions using for example permission less blockchain and decentralized platforms, please explain the regulatory approach that you favour. Please explain your reasoning.

We share the views expressed by the European Commission consultation on page 30. We believe that technology needs to be more mature in order to be used in financial markets in a safe way. The legislation should not be drafted based on a few use-cases, theoretical or just proven concepts, without further clarity on its possible use and risks to cater for in any legislation.

We believe that the financial stability risks resulting from the use of the public permissionless and decentralised platforms not having an accountable service provider are incompatible with the needs of financial markets.

Technology is an enabler to perform services, i.e. DLT could be seen as an evolution for the financial industry.

FMI (such as exchanges/MTFs, CCPs and CSDs) today provide important functions to markets as proven in and after the financial crisis and will continue to do so in the future, using the technology compatible with the FMI responsibilities.

Question 109.

Which benefits and risks do you see in enabling trading or post-trading processes to develop on permissionless blockchains and decentralised platforms?

Absence of clear accountability is the main risk that is not compatible with the markets needs to rely on secure and legally compliant market infrastructure. As a result of the absence of accountability, we fear a high potential for significant operational, regulatory, investor protection risk, as well as risk related to the integrity of the issue.

Furthermore, at the current stage we have a lot of unanswered questions on how some processes can be enabled on decentralised platforms. We believe that the technology may not address additional regulatory needs, such as the possibility to reverse the transactions or, if possible, auditability and data protection.

We see the risk of shifting responsibilities in operating financial markets to systems/platforms which in case of malfunctioning or abuse may deteriorate trust in the financial markets.

It has to be ensured that the principle of tech-neutrality within the regulatory framework is upheld. As long as the operator is compliant with the rules, in general, the used model of IT-system should not be a matter of high importance.

Question 111.

Have you detected any issues beyond those raised in previous questions on specific provisions that would prevent effectively applying EU regulations to security tokens and transacting in a DLT environment, in particular as regards the objective of investor protection, financial stability and market integrity?

In our view it would be beneficial to check, how technology is able to abide to the existent regulatory needs and requirements, such as:

- *Ensuring the integrity of the issue*
- *Clarity on the applicable law*
- *Clarity on who takes the accountability for operational, settlement and other risks*
- *Clarity on the settlement finality*
- *Auditability and data protection*
- *Ensuring AML/CTF and KYC obligations*

In particularly, we note the need for clear accountability of the service provider. This is especially relevant because the risks noted by IOSCO⁴ that could arise where a Crypto-assets Trading Platform (CTP) offers custody include the following:

- *Operational failure;*
- *Theft, loss or inaccessibility of private keys;*
- *Comingling of assets;*

⁴ IOSCO, Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms Final Report, February 202, p. 13. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD649.pdf>

- *Inaccurate record-keeping; and*
- *Insufficient assets to meet liabilities.*

Another risk for the market that is not yet considered is the risk of fragmentation and undoing the harmonisation achieved. The markets benefit today from high level of efficiency and liquidity largely due to joint industry efforts, considerable harmonisation in issuance, processing and servicing of different types of instruments have been achieved. More work still needs to be done in order to achieve full harmonisation. These efforts shall not be jeopardized, by fragmenting the solutions due to the different technology that would be used. Where possible, the introduction of a specific regime shall be done respecting the achieved level of harmonisation and interoperability.

Ends