

BVI position on the Commission's proposals for a regulation on markets in crypto-assets and a pilot regime for DLT-based market infrastructure

BVI¹ would like to take this opportunity to provide its views on the proposed framework for markets in crypto-assets (MiCA) and the pilot regime for market infrastructure based on distributed ledger technology (DLT).

Generally, market penetration of crypto-assets will depend a lot on whether crypto-assets only exist in parallel to traditional assets or whether they will replace traditional (paper-based) assets, such as shares. Investments in crypto-assets by the investment fund industry will, in particular, depend on the extent that the regulatory framework for AIF/UCITS funds permits such investments.

1. Establish a European regulatory framework to facilitate the issuance of crypto-assets and to allow for investments by investment funds

An EU regulatory framework should provide a level playing field between crypto and traditional investments in terms of transparency / disclosure obligations as well as risk management for the benefit of investor protection. The fraudulent activities and market abuse currently perceived as linked to crypto-assets should be limited to an adequate level commensurate with existing operational risk in the capital markets. While to some extent the same risks exist when handling traditional as with crypto-assets, there are also specific differences due to the underlying technology (DLT), which require a different risk assessment and tailored regulation, for example, regarding the proper functioning of 'smart contracts' (programs that run on DLT and automatically process legally binding transactions, such as transfer of ownership in digital assets without a third party). At the same time, DLT has an enormous potential for innovation in the financial markets infrastructure, e.g. mitigating counter party risk through transactions settled by the method of delivery vs. payment. This ultimately requires that a digital Euro / Euro denominated stablecoin is made available for transactions on a blockchain (cash on ledger). Against this background, we welcome that the European Commission has come forward with proposals on crypto-assets and DLT.

1.1. MiCA²

The scope of the proposal on MiCA covers those crypto-assets that are outside the scope of existing EU financial market regulation. With regard to MiCA Chapter 1 on asset-referenced tokens, Article 34 ("Investment of the reserve assets") should take into account that such an activity is comparable to that of an asset manager. The requirements for the management of the reserve assets should therefore be

¹ BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 113 members manage assets more than 3.6 trillion euros for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

² <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020PC0593&from=EN>



based on the corresponding rules of fund regulation (AIFM/UCITS Directives and Money Market Funds (MMF) Regulation), to provide a level playing field ensuring investor protection. In particular, the issuer of asset-referenced tokens should be able to demonstrate sufficient expertise in the area of risk and liquidity management, e.g. reflecting the operational requirements of the MMF Regulation (EU) 2017/1131, or entrust a management company with the management and investment of the reserve assets.

The fact that the provision of services in connection with crypto-assets, including investment advice on crypto-assets to clients, will be subject to authorisation is certainly in the interest of investor protection. In this context, the MiCA framework should also contain provisions on the management of a portfolio of crypto-assets for clients as this service is not yet specifically regulated as opposed to crypto-assets advisory services. We therefore suggest including this service in the MiCA regulatory framework. The provisions on portfolio management in the Markets in Financial Instruments Directive (MiFID II) could serve as a suitable template.

1.2. DLT Pilot Regime³

The proposed pilot regime breaks new technical ground and even deviates in part from the existing rules of financial market regulation. In principle, we understand that the pilot has more the character of a sandbox and that the market caps, as stipulated in Article 3 of the Commission's Proposal, are intended to keep the risk to financial market stability as low as possible.

At the same time, we would like to point out that the purpose of the pilot is also to gain valuable experience which requires a critical number of users of the DLT market infrastructure. However, the market capitalization and issuance volume restrictions for DLT-transferable securities could mean that the relevant offers will not be met with enough demand from the buy-side. Small-volume and non-liquid financial instruments are not on the radar of most professional market participants. Therefore, we have doubts as to whether professional investors, such as investment fund companies, would want to provide the necessary investment costs to connect to the new DLT market infrastructure if there is no commercially viable business attached to it.

Furthermore, we believe it would make sense to consider exchange-traded funds (ETF) in the form of DLT-ETFs that only invest in DLT-transferable securities. There are three supporting arguments for this suggestion: First, by including fund shares, experience could be gained that goes beyond shares and bonds, thereby placing the evaluation of the pilot regime on a broader basis. Secondly, DLT-ETFs would be the natural demanders for DLT-transferable securities, meaning that supply and demand would be meaningfully combined on the new DLT market infrastructure, resulting in better economic viability for the operators. Thirdly, regarding market stability concerns, DLT-ETFs do not create additional risks because the DLT-ETFs are only investors in DLT-transferable securities, and therefore the issuer risks posed by the DLT-transferable securities do not change or expand. If the market value of the DLT-transferable securities and the DLT-ETFs share values are added, merely the nominal volume increases. Hence, DLT-ETFs should not be bound by additional market caps or included in the operators' caps (as opposed to shares and bonds, cf. Article 3 (1) and (3) of the Commission's Proposal).

³ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020PC0594&from=EN>



2. Develop EU-wide market standards for crypto-assets

We strongly support the development of market standards for crypto-assets and are involved as a founding member of the International Token Standardization Association (ITSA). Similar to the ISIN for traditional securities, the International Token Identification Number (ITIN) is intended to create a binding identification standard for cryptographic tokens. Further, we welcome the initiative of the International Organization for Standardization (ISO 24165) to develop a Digital Token Identifier (DTI) for all fungible tokens. Moreover, all actors in the digital value chain should be identified via the Legal Entity Identifier (LEI).

Token standards must be sufficiently detailed to allow for clear identification of tokens which represent “financial Instruments”, “deposits”, “currencies” or other investment categories mentioned in EU financial services regulation, including but not limited to AIFMD, UCITSD and MiFID II. The accompanying regulation should also clarify that the relevant investment represented by tokens is eligible for the corresponding investment vehicle in question, e.g. investment funds structured as UCITS or AIF.

3. Uniform custody of all types of assets by custodians of investment funds

In general, the assets of an investment fund are held by a depository - an entity independent from the fund's investment manager. In order for this safekeeping to take place in an operationally meaningful way in the future, depositaries have to be entitled to conduct the safekeeping regardless of whether they relate to traditional or crypto-assets, which include payment tokens such as a digital Euro.