



FESE Position Paper on the DLT Pilot Regime

Brussels, 8th February 2021

We welcome the objective of the European Commission to empower people with a new generation of technologies and, in particular, the opportunity for the financial sector to issue financial instruments using Distributed Ledger Technology (DLT). As such, we support the proposal to include DLT instruments in the MiFID II definition of a financial instrument.

The main benefit of a DLT Pilot Regime lies in its ability to gather all DLT initiatives in a supervised innovation hub. It would provide a venue for experimentation whilst, at the same time, ensuring tailored supervision and gathering know-how of the activities, services or products which are eligible in scope, particularly with respect to investor protection.

As a general remark, we would highlight that technology neutrality and “same business, same risks, same rules” principles should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity.

Keeping the scope limited

The proposed Regime rightfully includes thresholds to determine which financial instruments can be admitted on a DLT MTF. It also includes a threshold on the total market value that a DLT MTF/CSD can record. This Regime should, in our view, be designed in such a way that it presents low risks to ensure financial market participants are protected and the proper functioning and stability of the financial system. As such, and as this proposal is designed as a pilot, it should be limited in scope and should not result in a perpetual “parallel regime”, which would increase the risk of an unlevel playing field and double regulation. It should rather be a voluntary sandbox.

In contrast, according to initial market studies from exchanges, the proposal made by the European Commission for a DLT Pilot Regime would cover around 50% of listed equity securities in the EU, based on the criteria of eligible issuers having a market capitalisation of up to 200m EUR as per Art.3(1)(a). Estimates indicate that a 500m EUR issuance threshold for bonds represent more than 80% of bond issuances in the fixed income landscape, if we apply the criteria under Art.3(1)(b). In our view, this weakens the premise of the proposal for an *experimental* DLT Pilot Regime.

Therefore, in order to strike the right balance between innovation friendliness and security, we would suggest that the DLT Pilot Regime should be reduced in size by lowering the initial thresholds in Art.3(1). This would prevent a DLT MTF from admitting a disproportionate number of instruments (currently available on financial markets).

Having said this, we agree that the Regime should allow room for innovation and experiment on a reasonable basis. Therefore, we would also argue that the thresholds could be reviewed during the pilot phase, depending on its development as we explain in the section below. In either case, once the thresholds are met by a participant, exit strategies must be executed.

Risks related to the timeline

As indicated above, we believe that the DLT Pilot Regime should remain temporary, voluntary and limited, allowing market participants to adjust to the new technology without creating a more favourable “parallel regime” for existing financial regulatory frameworks.

Furthermore, since a DLT MTF will require considerable efforts in terms of set-up and negotiation with National Competent Authorities (NCAs), it would also be important to clarify the longer-term ambition. An authorisation granted for a maximum of six years without certitude on whether the Regime will carry on permanently could constitute a hurdle for potential investments in such innovative projects. Moreover, in case the Regime would result in a disproportionate number of securities being admitted on a DLT MTF, this would create instability on traditional markets. A six-year timeframe without intervention would be too long.

We would advise amending Art.10(1) to include a mid-term review of the Regime, allowing room for adjustments. A final review after 5 years at the latest, as foreseen already by the proposed text under Art.10(1) and (2), should help to determine whether to extend, transform or terminate the Pilot Regime.

Risks related to DLT MTFs

The term “DLT MTF” is misleading, as it is a ‘new’ type of actor offering a DLT market infrastructure with functions such as trading, notary, settlement, custody etc. Since “DLT MTFs” would be allowed to perform some activities normally performed by other financial market infrastructures (like CSDs) within the proposed Regime, the same level of safeguards as in the current regulatory environment (e.g. established in the MiFID/MiFIR, CSDR, SFD, MAR) should be upheld. This is even more important if roles/functions would overlap, as currently indicated in the text, or be transferred into the current regulatory framework. The foreseen exemptions need to be justified against the background of market integrity, consumer protection and overall security.

In particular, without corresponding changes in CSDR, the exemption from Art.3(2) of CSDR could result in an entire exemption from the CSDR framework. This could undermine market integrity as the requirements set in CSDR exist to ensure the orderly settlement of transferable securities on trading platforms and, thus, maintain confidence in the functioning of markets. If a DLT MTF would perform such activities, the same level of safeguards as in the current post-trade environment should be upheld. In FESE’s view, the requirements within the CSDR framework provide the best measures to ensure the same level of market integrity, consumer protection, and security even in a DLT environment.

As the proposed Regime may lead to unforeseen loopholes in the existing financial rules, we believe that any exemption needs to be reasonably justified and clearly outlined at Level 1. Furthermore, the report foresaw by Art.9(4) could be published partially or in its entirety, in the interest of transparency and to inform future practices.

Ensure effective cooperation arrangements

Art.4(1) of the Pilot Regime provides that NCAs may impose additional requirements on a DLT MTF. FESE believes that the cooperation arrangements foreseen between operators of DLT market infrastructures, NCAs and ESMA (under Art.9) will play a key role on the implementation of the Regime, in order to avoid fragmented or uneven scenarios.

Ensure the appropriate safeguards

Furthermore, the proposal envisages the possibility for natural persons to be directly admitted to trading as participants on a DLT MTF. We welcome the fact that retail investors are not per se excluded from participating in the Pilot Regime, but we believe that policymakers should further assess the full impact of this proposal and ensure appropriate and harmonised safeguards. In this regard, we believe that ESMA would be best placed to draft, at Level 2, the right measures to enhance investor protection, while fostering innovation.