

FESE response to the ESMA Call for Evidence on the DLT Pilot Regime

4th March 2022, Brussels

Q1 Please provide any general observations or comments that you would like to make on this call for evidence, including any relevant information on you/your organisation and why the topics covered by this call for evidence are relevant for you/your organisation.

The FESE members are committed to the highest standards of transparency, resilience and investor protection to support safe and stable financial markets. The implementation of the MiFID/MiFIR transparency and reporting requirements aimed to foster the investor protection and the growth of transparent markets. Transparency requirements, in particular, are pivotal to market structure. In our view, the creation of a subset of these requirements for sake of the DLT regime would not be beneficial for the functioning of the overall market and could cause further fragmentation of market structure and liquidity pools to the detriment of price formation. Not least, a harmonised regulatory approach with respect to reporting requirements is essential to ensure convergence in supervisory practices. Especially as the DLT regime will process similar instruments to those traded on public markets, it is vital to ensure a similar level of information on the transactions in these instruments.

As the introduction of the DLT pilot regime could potentially lead to the increased use of DLT (trading the same instruments as currently available on public markets) in financial markets, it is vital to ensure that the current levels of transparent markets and investor protection are safeguarded for every trading environment.

DLT is potentially a catalyst for record keeping and transaction processing for financial instruments but has no impact (i) on the inner financial instrument characteristics (i.e. the rights allocated to investors and the duties imposed on issuers) nor (ii) on price formation mechanisms for fair, orderly and efficient secondary markets. DLT will enable to process the same type of instruments already traded on transparent lit markets. Hence the DLT Pilot Regime, whilst opening the possibilities to record and transact on financial instruments leveraging DLT, should not be accompanied by a structural revision of the transparency requirements applicable to operators and participants: overall, pre-trade and post-trade transparency should continue to be a priority, even if, given the DLT Pilot Regime's features, transparency provisions will have to be extended to apply to direct orders from end-investors.

In that respect we believe no changes are needed to the MiFIR framework as this is the basis for the overall price formation process of all financial instruments and the treatment of (retail) investors, ensuring best execution.

In addition, it is important to note that there are still some risks with respect to DLT that need to be carefully monitored throughout the process to ensure investors are not disproportionately negatively impacted. We would urge ESMA, before making any

alleviations to the current transparency regime, to carefully monitor any unintended consequences as a result of the framework as it is proposed now.

As trade association, FESE will not reply to company-specific questions in this call for evidence. However, we believe some more general remarks should be mentioned.

We would highlight, in particular, 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. Transparency requirements in particular are pivotal to the market structure and are calibrated on different asset classes, the creation a subset of these requirements specific to the use of DLT technology would not be beneficial for the market and could cause a potential fragmentation of the market structure and of pools of liquidity. Harmonised reporting requirements are also important to ensure convergence in supervisory practices, allowing for integrating analysis of the markets to ensure investor protection.

We support ESMA’s view regarding the “technology neutrality” principle when it comes to potential amendments to MiFIR Regulatory Technical Standards (RTS). We appreciate ESMA’s two-steps approach of collecting market participants’ feedback in this Call for Evidence first, and consulting on potential concrete changes afterwards.

We would like to share some overarching comments:

- RTS should stay “technology neutral” and consistent. We share ESMA’s view that the existing RTS are designed in a “technology neutral” manner and that the introduction of new technologies should not lead to significant changes. Amendments to existing RTS on reporting should be limited and need to ensure that the data/information regarding traditional financial instruments is comparable to those of their “tokenised” equivalents. Additionally, significant changes to the RTS should be avoided to secure the “same business, same risk, same rules” principle. It should not matter whether a financial instrument is issued “traditionally” or on a DLT. Further, consistency between RTS used in the DLT Pilot Regime and those already implemented will be especially important once participants will have to exit the Pilot environment and transit into standard market infrastructures (MIs). If Level 2 legislation is not consistent it could lead to confusion and market instability once participants start to execute their exit strategies, as they would have to change a lot of internal procedures in a potentially short amount of time. The smaller the changes to the existing RTS, the easier it will be to draw lessons from the DLT Pilot Regime afterwards and potentially adapt it to the existing legislation. Transparency obligations and regulatory reporting rules need to be clear as soon as possible. Although it is questionable whether participants would have the necessary authorizations and/or a DLT MI ready at the same time the DLT Pilot Regime officially starts, the relevant RTS need to be in place and the regulatory expectations are clearly communicated as early as possible. Participants need clarity on which requirements they must comply with when designing their systems to have them ready on day one. It is important to avoid situations where participants are unsure on what to report to whom. On the other hand, competent authorities must be in the situation to detect potential misconduct and enforce compliance at all times.
- As the DLT Pilot Regime is only designed for a limited period, it would be detrimental for the success of this project to delay its implementation (e.g. due to a postponement of the application of some rules). Hence, it would be most valuable if ESMA and national competent authorities can provide additional guidance on the respective RTS and other relevant requirements ahead of the application of the DLT Pilot Regime. This becomes even more relevant as participants can ask NCAs for specific exemptions from existing rules and requirements like MiFID II and CSDR within the Regime. This

might lead to a complex situation in which some requirements will apply to some, but not to all participants and potentially in different ways. Participating firms may be less incentivized to participate, given the time needed to implement the processes while being faced with uncertainty.

- If transactions occur on the same DLT MI, transparency rules must be clear.

Overall, FESE believes that it is key to draft RTS that are technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content as a separate initiative, not addressed to a specific type of technology that is used for trading/settlement.

Q2 Please indicate whether you/your organisation is planning to operate a DLT MI under the DLT Pilot and provide some high-level explanation of the business model

Q3 What are the key elements supporting the increased use of DLT in the field of financial services? What are the main obstacles, including in the technical standards, for the development and up-take of DLT-based solutions (listing, trading and settlement)? Do you plan to operate a restricted (permissioned) or unrestricted (permissionless) distributed ledger?

One major element supporting the use of DLT in the financial services sector is the increasing legal certainty at the EU level and on Member States. However, it should be ensured that the regulatory frameworks are consistent, compatible, and ideally harmonised. Other key elements are transparency, instant settlement, a direct connection between issuer and investor, more efficient processes, and cost savings.

Q4 Would you consider operating a DLT MTF Would you consider operating a DLT SS without operating at the same time a DLT MTF? If yes, under which conditions?

Q5 Please provide an overview of how DLT securities trade in the current market structure (incl. what types of trading system are used, the relevance of secondary market trading)? Do you see any challenges with the current market structure following the application of the DLT Pilot?

Q6 Instrument status: Do DLT financial instruments have different characteristics than ‘standard’ shares, UCITS-ETFs and bonds? If yes, please elaborate and explain whether these different characteristics call for a different approach for the application of the transparency requirements?

DLT financial instruments do not have different characteristics than ‘standard’ shares, UCITS-ETFs and bonds, as the core characteristics of DLT and ‘standard’ instruments are the same. The use of DLT of the issuance, recording, transfer and storage of those securities does not change the legal nature or the economic value of those instruments.

Q7 Transactions: Where are DLT financial instruments traded? Could there be OTC trading in those instruments?

OTC trading might exist for DLT financial instruments, as well as for other crypto-assets. Using the DLT technology does not imply on-market trading. Current OTC trading in DLT instruments is purely bilateral, and we believe that existing MiFID II/MiFIR rules should equally apply.

Q8 Transactions: Do the lists of transactions in Article 13 of RTS 1 and Article 12 of RTS 2 reflect relevant transaction types for DLT financial instruments? If not, please explain which types of transactions are missing and why they should be added to the lists of transactions.

Q9 Can the current transparency requirements in RTS 1 and 2 be applied for DLT financial instruments (e.g. liquidity assessment, thresholds, flags, reporting fields) or would they need to be adjusted? If not, what should be the appropriate approach?

As mentioned already in Q1, FESE believes that, although there might be some more technical adjustments to be made, DLT MTFs/TSSs should follow the same transparency requirements that are today applicable to standard MTFs. It is key to draft RTS that are technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content in a separate initiative.

Q10 Are there any standards (e.g. messaging, identification of accounts/users, product identifiers, reporting, etc.) in a DLT environment that should be taken into account when revising the RTS 1 and 2?

Q11 Do you anticipate any problems that may emerge from the current liquidity concepts in Delegated Regulation (EU) 2017/567 and RTS 2 for the application of related transparency requirements for DLT financial instruments? Please explain and make proposals on how such problems could be solved.

Q12 Are DLT securities traded on different trading systems as ‘standard’ shares and UCITS-ETFs (mostly continuous trading and periodic auctions) or bonds (RFQ, voice trading)? Please explain.

Q13 To what extent would the choice of trading protocols and applications have an impact on the trading of instruments and on the requirements to publish information according to RTS 1 and 2?

Q14 Do the systems on which DLT financial instruments trade require tailored pre-trade transparency requirements as those per Table 1 Annex I of RTS 1 and Annex I of RTS 2?

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Q15 Would the use of restricted (permissioned) vs unrestricted (permissionless) DLT represent any difference in how the pre-trade transparency requirements should be applied?

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Q16 Is it in your view necessary to make changes to the calibration of waivers for DLT shares and UCITS-ETFs in RTS 1? Do you expect any implementation issues in the application of waivers also taking into account the above considerations?

As mentioned already in Q1, FESE believes that, although there might be some more technical adjustments to be made, DLT MTFs/TSSs should follow the same transparency requirements that are today applicable to standard MTFs. It is key to draft RTS that are technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content in a separate initiative.

Q17 Is it in your view necessary to make changes to the calibration of waivers for DLT bonds in RTS 2? Do you expect any implementation issues in the application of waivers also taking into account the above considerations?

As mentioned already in Q1, FESE believes that, although there might be some more technical adjustments to be made, DLT MTFs/TSSs should follow the same transparency requirements that are today applicable to standard MTFs. It is key to draft RTS that are technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content in a separate initiative.

Q18 What can be considered as close to real-time as possible for the publication of post-trade reports in the context of DLT-securities on DLT MIs?

Q19 Are the current deferral periods for equity and non-equity instruments appropriate for DLT securities? Please, distinguish between DLT shares, ETFs and bonds.

As mentioned already in Q1, FESE believes that, although there might be some more technical adjustments to be made, DLT MTFs/TSSs should follow the same transparency requirements that are today applicable to standard MTFs. It is key to draft RTS that are

technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content in a separate initiative.

Q20 Is it necessary to amend the current fields and flags for post-trade transparency (modifications/cancellations/additions) for their application to DLT shares, ETFs (Tables 2, 3 and 4 of Annex I of RTS 1) and bonds (Annex 2 of RTS 2)? Do you expect any implementation issues on basis of the current fields and flags?

Q21 Is it necessary to amend RTS 3 for the purpose of the DLT Pilot? Do you anticipate any problems with the application of RTS 3 under the DLT Pilot?

As mentioned already in Q1, FESE believes that, although there might be some more technical adjustments to be made, DLT MTFs/TSSs should follow the same transparency requirements that are today applicable to standard MTFs. It is key to draft RTS that are technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content in a separate initiative.

Q22 Do you agree with the approach indicated in the above paragraph? Please justify your answer.

As mentioned already in Q1, FESE believes that, although there might be some more technical adjustments to be made, DLT MTFs/TSSs should follow the same transparency requirements that are today applicable to standard MTFs. It is key to draft RTS that are technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content in a separate initiative.

Q23 Private individuals: Do you agree that DLT MTFs could report transactions on behalf of the private individual as part of the compensatory measure foreseen by Article 4(1)(c) of the pilot regime? Please explain your statement. What other solutions can be explored to address this data gap?

Q24 Reporting status and transaction reference numbers (Fields 1 and 2): How will DLT MTF treat cancellations to correct previously submitted information as per Section 5.18 of ESMA Guidelines on transaction reporting being the information stored on DLTs immutable? Is it necessary to amend the current fields 1 and 2 for their application in the context of a DLT environment? Do you foresee any other reporting status other than New and Cancellation in the context of a DLT environment?

As mentioned already in Q1, FESE believes that, although there might be some more technical adjustments to be made, DLT MTFs/TSSs should follow the same transparency requirements that are today applicable to standard MTFs. It is key to draft RTS that are technology neutral, avoiding different rules applied depending on the technology used. The “same business, same risks, same rules” principle should apply to uphold the values

of transparency, fairness, stability, investor protection, and market integrity. ESMA should conduct a review of the regime in terms of content in a separate initiative.

Q25 Trading Venue Transaction Identification, TVTIC (Field 3): Is it necessary to amend the current field for its application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q26 Executing entity and submission entity identification codes; MiFID II Investment Firm indicator (Fields 4-6); Buyer details and decision maker (Fields 7-15); Seller details and decision maker (Fields 16-24): Is it necessary to amend the current fields for their application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q27 Transmission of an order (Fields 25-27): Is it necessary to amend the current fields for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q28 Trader, algorithms, waivers and indicators (Fields 57-65): Is it necessary to amend the current fields for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q29 Short selling field (Field 62): Is short selling possible? Does it depend whether it is a DLT MTF or a DLT MTF+DLT SSS? Is it necessary to amend the current field for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields?

Even as this seems not possible within the DLT Pilot Regime, we believe that, depending on the market model, short selling should be possible within a DLT MI allowing for settlement cycles by embedding short selling algorithms in the design of smart contracts used for settlement on the DLT.

Hence, in theory, short selling is possible without having the securities in your account without your trade being covered by settlements. Therefore, we believe it is not necessary to amend the current field 62 for the application in the context of a DLT environment.

Q30 Transaction details (Fields 28-40): Is it necessary to amend the current fields for their application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q31 What are your views on the arrangements that DLT MTFs would need to establish to ensure the provision of complete and accurate reference data to ESMA? Do you think that the current arrangements described in RTS 23 should be amended to ensure its application in the DLT environment? Do you expect any implementation issues on basis of the current RTS 23?

Q32 Issuer related fields (Field 5): Is it necessary to amend the current field for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q33 Venue related fields (Fields 6-12): Is it necessary to amend the current field for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q34 Notional (Field 13): Is it necessary to amend the current field for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

We do not see the need to add new fields, apart from including a field for notional e-money in case there is no notional currency involved.

Q35 Bonds or other forms of securitised debt related fields (Fields 14 - 23): Is it necessary to amend the current field for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q36 Do you agree with ESMA's assessment that no major amendments to RTS 25 appear necessary for the implementation of the DLT Pilot?

Q37 Do you think the definition of "order" is still applicable to the DLT context? Are the order record keeping requirements in Article 25 and related RTS 25 applicable in the DLT context? If yes, how do you envisage to comply with such requirements? If no, please justify your answer.

Yes, the definition of "order" and the order record keeping requirements are still applicable in the DLT context.

Q38 Can chains of transmission on DLT financial instruments occur?

Yes, we expect that chains of transmissions via different intermediaries will still occur to connect retail clients with the DLT MI.

Q39 Is it possible to split or aggregate orders? In or out the DLT? Or both?

Q40 Does the concept of “Transmission of an order” defined in Article 4 of RTS 22 make sense in the context of DLT? If so, when would you consider an order to be transmitted?

Q41 What do you consider are the phases of a DLT transaction? At what point in time can such a transaction in DLT securities be considered executed? How do you think “broadcast the transaction to the network” should be defined?

Q42 Do you think the definition of “transaction” is still applicable to the DLT context?

Yes, the definition of "transaction" is still applicable in the DLT context.

Q43 General fields (Fields 1 - 3), ISIN for RTS 1-3: Is it necessary to amend the current fields for the application in the context of a DLT environment? Do you expect any implementation issues on basis of the current fields? Should new fields be added in the context of a DLT environment?

Q44 Should a new field indicating the DTI be added to RTS 23 and RTS 1-3? What kind of analysis could be performed on a tokenised security by coupling ISIN and DTI information?

Q45 Is the ISIN sufficient to ensure uniqueness of a given tokenised financial instrument? Is there any element of the DTI standard that you consider should be added as a separate field in RTS 23 and RTS 1-3?

Q46 Traditional reporting systems - RTS 22/23: Does the setting up of the traditional reporting systems as illustrated in Annex 1 of the ESMA Guidelines on transaction reporting make sense in the context of the pilot regime?

Yes, NCAs should continue to receive information in a standardised format from the venues/investors.

Q47 Execution and IT infrastructure - RTS 22/23: Does the fact that execution takes place on a DLT has an impact on the investment firm’s reporting system and requires setting up of separate/new IT infrastructures?

Q48 ISO standards 20022 and RTS 22/23: Can ISO 20022 be implemented and used by DLT MTFs or DLT TSS and/or their members/participants to comply with the reporting required under Article 26 and 27 of MiFIR. Do you think ISO 20022 would represent an opportunity or an issue for DLT MTF? Please explain your statement.

Q49 XML template of RTS 22/23: do you think that different formats might be more suitable to the DLT while keeping the common ISO 20022 methodology? If yes, please explain what the most appropriate format would be and for which reasons.

Q50 Do you/your organisation plan to offer settlement of DLT securities in e-money tokens? If yes, what would be the most appropriate way for reporting these transactions? Do you agree with ESMA's proposal on how to populate the currency fields when the financial instrument is priced in e-money tokens?

Q51 Do you consider it possible that transactions in DLT securities could be settled in different currencies and/or different e-money tokens? If yes, please explain what would be the most appropriate way for converting such transactions in EUR.

Q52 What are your views on the arrangements that DLT MTFs and DLT TSSs would need to establish to grant direct and immediate access to transaction data to regulators by admitting them as regulatory observer participants? Do you expect any implementation issues in relation to the obligation to make MiFIR transaction data available to the NCAs and MiFIR transparency/ reference data to ESMA?

Q53 Is it technically feasible to store on the DLT the details of the transaction according to ISO 20022 methodology in order to enable regulators to pull that data directly into a readable format without any transformation of the data? Do you believe that the use of ISO 20022 could have a significant negative impact in terms of scalability of the system and the related congestion risk? If yes, please justify your answer and specify if the impact is dependent on the type of governance model and technology that the DLT is using.

Q54 Can all information to be reported under MiFIR Article 27 pursuant to Table III of the Annex to RTS 23 be recorded on the DLT according to the ISO 20022 methodology? Please explain your answer also in relation to scalability impact at DLT level.

Q55 Can all data necessary to perform the transparency (Article 2 of RTS 3) and DVC (Article 6 of RTS 3) calculations be recorded on the DLT according to the ISO 20022 methodology? Please explain your answer also in relation to scalability impact at DLT level.

Q56 Do you see any issue with obtaining the data elements required by RTS 22 and 23 from external databases like GLEIF, ISO 4217 list (currencies), ISO 10383 (MIC) or ANNA-DSB

(ISIN) before the data is permanently stored into the distributed ledger? Please explain your answer.

Q57 Do you see any major impediments for the regulator as a regulatory observer participant to pull large size of encrypted data from the distributed ledger? Please explain your answer in the context of encryption of data and key management, and in relation to any scalability impact at DLT level.

Q58 Taking into consideration the variety of technologies available in the DLT world, what is, in your opinion, the most efficient way to admit regulators as regulatory observer participants? Please explain your answer.

Q59 Do you have any suggestion to ensure interoperability among DLT MTFs, DLT TSS and the regulators as described in Paragraph 126? Please explain your answer.

Q60 Do you have any suggestion to ensure interoperability among different DLT MTFs and/or DLT TSS as described in Paragraph 127? Please explain your answer.