Frankfurt,
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BVI position on the Call for evidence on the DLT Pilot Regime

General Comments

BVI[1] would like to take this opportunity to reiterate its views on the proposed 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, including but not limited to the DLT pilot, 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 stable coin 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.

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

[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 116 members manage assets of some EUR 4 trillion 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.

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 makes 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 economy viability for the operators. Thirdly, especially regarding market stability concerns, DLT-ETFs do not create additional risks because the DLT-ETFs are only investors in the DLT-transferable securities, and therefore the issuer risks posed by the DLT-transferable securities do not change or expand. DLT-ETFs should therefore not be bound by additional market caps or the operation caps (as opposed to shares and bonds, cf. Article 3 (1) and (3) of the Commission’s Proposal), as only the nominal volume increases if the market value of the DLT-transferable securities and the DLT ETF share values are added, but not the risk.

Finally, there is a need for uniform custody of all types of assets by custodians of investment funds. In general, the assets of an investment fund are held by a depositary - 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.

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

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.

We strongly support the development of market standards for crypto-assets. All actors in the digital value chain should be identified via the Legal Entity Identifier (LEI). We are involved in standard setting 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. In this respect we participate in the Digital Token Identifier Foundation (DTIF) Product Advisory Committee (PAC) and support the DTIF PAC general comments and specific answers as stated below:

The ISO 24165 Digital Token Identifier standard (DTI) caters for identification of digital assets and includes representation of tokenized financial instruments, e-money tokens as well as other digital assets such as cryptocurrencies, virtual currencies, utility tokens, stable coins, etc. The DTI uniquely identifies a digital token based on objective and publicly verifiable technical characteristics of the digital token. Inclusion in the registry and the issuance of a DTI guarantees the existence of the token and its 1:1 relationship to its identifier in all circumstances, including after complex events such as forks on a blockchain. The DTI Foundation, a non-profit division of E-Trading Software, is responsible for the issuance and management of DTIs under its Registration Authority Agreement with ISO.

The design of the DTI explicitly caters for consistency with the International Securities Identification Number (ISIN) standard (ISO 6166) which is already embedded within the existing regulatory regime. The DTI record already contains fields to link the DTI to external identifiers such as the ISIN and the DTI Foundation will include the corresponding ISIN within these fields.

With respect to ESMA's Call for Evidence, the PAC welcomes ESMA's focus on interoperability between DLT Market Infrastructures (DLT MI). The PAC considers interoperability an essential element to promote innovation and competition between DLT MIs as well as between different DLTs themselves. As such, the PAC urges ESMA to consider the promotion of interoperability as a key consideration for the revision of the relevant RTS texts.

As noted by ESMA, there are several market initiatives to create interoperability solutions. It is important for ESMA's RTS text revisions to remove any potential regulatory obstacles to the market adoption of such solutions. Specifically, the RTS texts should not make any assumptions that restrict the trading or settlement of a DLT financial instrument to a single DLT or to a single DLT MI. Indeed, ESMA can help promote such interoperability by ensuring the relevant RTS texts make explicit allowance for DLT financial instruments to trade and settle on multiple DLT MIs and on multiple DLTs. The PAC has provided suggestions on how to achieve this in the answers to the specific questions below.

Specific Answers

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?

Taking into account the DTI standard when revising RTS 1 and 2 can aid market transparency for DLT financial instruments in the following use cases:

- In the case of a fork event;
- In the case where the same DLT financial instrument trades on multiple DLT chains; and
- In the case where multiple DLT financial instruments across chains were functionally fungible.

Please see our response to Q44 for further details on each of the above use cases.

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?

Adding the DTI to RTS 23 reference data can address the following DLT specific complexities:

- If a hard fork were to occur on the chain where a DLT financial instrument resides.
  In this case, the original token will have new 'copies' on both forks. It will be important to identify unambiguously which fork and token represents the 'real' DLT financial instrument. The

DTI can perform this identification, because following a hard code, each ‘copy’ of the token will receive its own DTI, thereby allowing unambiguous identification of which one is the ‘real’ DLT financial instrument; and,

- If regulators need to configure their systems to consume data directly from the chain. In this case, ESMA’s systems will need to understand the relationship between the DLT financial instrument and the associated chain(s) the transaction data resides on. The DTI metadata provides a link between the DLT financial instrument and the chain(s) where the token is implemented, thereby providing a machine-readable mechanism to identify which chain(s) the transaction data will be available on.

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?

The addition of the DTI (whether in the General fields section or in a different section) would add value in the use cases described in our responses to Q44.

The DTI record already contains fields to link the DTI to external identifiers such as the ISIN and the DTI Foundation will include the corresponding ISIN within these fields to simplify linkage of the different identifiers by market participants and public authorities.

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?

The DTI provides guaranteed uniqueness of the digital token based on objective and verifiable technical data. The DTI can also represent a group of functionally fungible digital tokens across multiple chains. The addition of the DTI provides the benefits described below:

- In the case of a fork on the blockchain containing the DLT financial instrument, each fork will contain its own copy of the original token that represented the DLT financial instrument. The DTI provides the ability to uniquely identify which copy of the token represents the DLT financial instrument after the fork event.

- In the case of the same DLT financial instrument trading or settling on multiple blockchains, the addition of the DTI enables market participants to identify the specific chain associated with any price or trade and therefore enhances market transparency by enabling analysis of best prices per chain. Regulators will also be able to take into account the chain where a given trade occurred when performing their market abuse monitoring function.

- In the case of multiple DLT financial instruments on different chains are deemed to be functionally fungible, a DTI can be issued to represent the group of DLT financial instruments. The DTI in this case can enhance market transparency by enabling aggregation of the order and market data across multiple chains across the functionally fungible DLT financial instruments.

For these reasons, the inclusion of the DTI in RTS 23 and RTS 1-3 would add value to market participants and public authorities.

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?

The DTI provides complementary information to the ISIN. Please see our response to Q44 for specific use cases where the inclusion of the DTI in RTS 23 and RTS 1-3 would add value.

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?

The scope of the DTI includes e-money tokens. Where settlement is in e-money tokens and not in fiat currency, the use of the DTI instead of the currency code (ISO 4217) can uniquely identify the specific e-money token used in the settlement process.

DTIF has already issued DTIs for many of the major e-money tokens in use today.

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.

There are two use cases where the addition of the DTI can aid in interoperability:

(i) When a DLT MI on-boards a new DLT financial instrument for trading or settlement.
The DTI enables MTFs to identify in a standard manner the chains that they support, and to describe in a standard manner which tokens they support on which chains. This standardised approach to the provision of this information aids interoperability across DLT MIs and regulators by providing a standard machine-readable mechanism for DLT MIs and regulators to determine which DLT financial instrument is trading or settling on which chain.

(ii) When a fork occurs on the chain where an existing DLT financial instrument is trading or settling.
After a fork, the DLT MI will need to identify to market participants and public authorities which fork and token represents the 'real' financial instrument. The DTI enables MTFs to identify in a standard manner the specific fork and token that represents the 'real' financial instrument. This standardised approach to identification of the fork and token aids interoperability across DLT MIs and regulators by providing a standard machine-readable mechanism for DLT MIs and regulators to determine which fork the DLT financial instrument is trading or settling on.

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.

In addition to the use cases described in our response to Q59, The DTI enables interoperability between DLT MIs by ensuring a consistent identification scheme for both chain and token. An example where this is relevant is in the case where multiple DLT MIs wish to trade or settle the same DLT financial instrument across multiple chains. The DTI enables such interoperability by providing a standard mechanism for each DLT MI to identify which chain and token it supports. Market participants will then be able to aggregate market data by each chain as well as aggregate market data across all chains. This may be important if the prices on different chains were to vary or if regulators wished to analyse market data per chain to identify whether market abuse was occurring on some chains more than others.

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