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**EACH response to the European  
Commission Public Consultation “On an EU  
framework for markets in crypto-assets”**

March 2020

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## Introduction

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The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 19 members from 15 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciates the opportunity to provide feedback to the European Commission Public Consultation “On an EU framework for markets in crypto-assets” (hereinafter called “The consultation”).

## Classification of crypto-assets

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**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)?**

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

**Please explain your reasoning (if needed).**

EACH believes that we need one single EU classification which covers both digital-assets, which represent the digitalized embodiment of an asset, as well as crypto-assets, which are a subcategory. Hence, crypto-assets – such as coin and token – are digital assets based on cryptography, but other categories of digital assets are imaginable. The classification should also refer to those services and activities related to these assets. A clear and distinct categorization of digital-assets between security, payment, utility and hybrid-asset is deemed by EACH of critical importance to determine if a given digital-asset falls under an existing EU regulative framework and to align the existing regulation.

Definitions should not be based on “technical” features only (e.g. cryptography), but, if possible, also on the value of the assets embodied i.e., if “digital securities” represent a “financial instrument” defined in MiFID II under Annex I, Section C of the MiFID II (1), then they should be treated as such instrument; for instance, if the embodied value is a share, then all rules for shares apply, if the embodied value is a commodity, then all rules for commodities apply).

A commonly, binding legislative approach, based on existing EU rules and regulations for the financial market would provide a much needed legal certainty to reduce regulatory arbitrage, inconsistencies and market fragmentation and to ensure scalability of services within the EU. This would place the EU as a global international standard setter, that embraces innovation. Tech-neutrality and “same business, same risks, same rules” should apply to uphold the principles of transparency, fairness, stability, investor protection and market integrity.

It is also important to have clarification by an actor at EU level, e.g. ESMA (in alignment with global standard setting bodies like ISO), that if digital-assets (like digital securities) qualify as a financial instruments due to their characteristics in a “substance over form” manner (see the MiFID II definition of financial instruments in the Annex I, Section C of the MiFID II), they will be subject to already existing financial rules. This would increase the speed-to-market for innovations, as market participants and authorities would act within a well-established legal framework and the rules are appropriate for institutional and retail investors.

If a hybrid-digital asset contains elements of a financial instrument at any point of its life-cycle, in principle, it should fall under the financial rules for the respective financial instrument.

Digital-assets, which are currently not covered by the current definitions of financial instruments (e.g. crypto-currencies) should be integrated in the MiFID II definition of financial instruments. We would propose to define a new category “other digital-assets” which could be defined in line with the definition provided for in the *German Banking Act (KWG)*<sup>1</sup>, which could act as a blueprint for the respective EU regulatory framework, see as an example: *“Digital-assets are defined as digital representations of value that are not issued or guaranteed by a central bank or a public authority, are not necessarily attached to a legally established currency and do not possess a legal status of currency or money, but are accepted by natural or legal persons as a means of exchange that can be transferred, stored and traded electronically or serve investment purposes other than e-money or a monetary value used in limited networks for certain exempt electronic payments processed by telecommunication providers.”*

In addition, EACH would prefer the following definition from the Fifth Anti-Money Laundering Directive (AMLD<sup>2</sup>): “A custodian wallet provider means an entity that provides services to safeguard private cryptographic keys on behalf of its customers, to hold, store and transfer cryptographic and other digital assets” The custodian wallet provider was already a defined term under AMDL and is considered a new “obliged entity” and therefore should be regulated. Utility assets which do not fulfil the criteria above, should still be treated in such a way that investors are protected and markets are fair, efficient and transparent (see e.g. [IOSCO objectives of Securities Regulation](#)<sup>3</sup>).

## Crypto-assets that are currently covered by EU legislation

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**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)?**

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<sup>1</sup> Official German version: [https://www.bundesrat.de/SharedDocs/drucksachen/2019/0501-0600/598-19.pdf?\\_\\_blob=publicationFile&v=1](https://www.bundesrat.de/SharedDocs/drucksachen/2019/0501-0600/598-19.pdf?__blob=publicationFile&v=1)

<sup>2</sup> Directive (EU) 2018/843 of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN>

<sup>3</sup> IOSCO - Objectives and Principles of Securities Regulation: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>

A recent market development that EACH would like to highlight regards the official approval in January 2019, by the German Federal Financial Supervisory Authority (BaFin), of [BitBond](#)<sup>4</sup>, Fintech enterprise which helps small businesses raise capital and which is now officially able to tokenize bonds. The security token is named BB1.

**55) Do you think that DLT could be used to introduce efficiencies or other benefits in the trading, post-trade or asset management areas?**

<b>Completely agree</b>	
<b>Rather agree</b>	<b>X</b>
<b>Neutral</b>	
<b>Rather disagree</b>	
<b>Completely disagree</b>	
<b>Don't know / No opinion</b>	

**Please explain your reasoning (if needed). If you agree, please indicate the specific areas where, in your opinion, the technology could afford most efficiencies when compared to the legacy system.**

EACH members understand the potential impact that DLT technologies may have on the CCP business and on financial markets, and are involved in initiatives to encourage the development and to explore the application of such technologies. More specifically, EACH believes that DLT might bring benefits in the following areas of CCP activities:

1. Reconciliation process

DLT may not only make the reconciliation process faster and more efficient but it may potentially make it unnecessary since the records are shared among participants. However, it currently seems unclear what the impact would be on the current value chain of market infrastructures: trading venues, CCPs, CSDs, CSD participants, final beneficiaries, etc. While every actor of the value chain currently plays a very specific role, market infrastructures are in constant evolution as a result of innovation and client demand, and therefore changes to the value chain as we know it cannot be discarded. CCPs have a proven track record of market adaption as shown by the constant evolution of their risk management techniques subject to client demand and in line with regulation.

2. Data for reporting

EACH generally believes DLT could potentially facilitate the collection, consolidation and sharing of data for reporting. However, DLT would operate in parallel to other systems, thus requiring reference to multiple sources in order to maintain complete oversight. Even assuming full deployment of DLT where applicable, certain processes or asset classes may not be suited to a DLT environment and may operate on separate systems, thus requiring again multiple sources to be consulted in order to maintain a

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<sup>4</sup> *BitBond*: <https://www.bitbond.com/#about>

complete picture. Moreover, a single source of truth implies a single DLT system in use. After consideration by the industry, it may be determined that there is not a single DLT that will serve all of the needs of the market, requiring multiple DLTs to be deployed and more than one record to be monitored. Further, generally we question some assumptions that DLT can handle a theoretically unlimited amount of information at an increased speed.

3. Counterparty risk of certain securities transactions

DLT presents the possibility to reduce the settlement cycle, thus reducing counterparty risk. It should be noted however that shorter settlement cycles (and even T-instant) are not a unique advantage of DLT, and indeed could be performed on many current systems. In the case of CCPs, DLT may indeed eliminate the counterparty risk of certain transactions (e.g. securities and repos) and remove the need for CCP clearing for some contracts, but this is only in those instances where the trading is either on DLT or can be transferred to the clearing system in real-time (if outside DLT), e.g. T-instant.

4. Collateral management

EACH believes that DLT could potentially make to collateral risk management more efficient, but such efficiency will depend on the number of asset classes (market segments) made available on the DLT (transaction type bundling), which in turn will depend on the appropriateness and applicability of DLT for each asset class and the ability of each participant to support the DLT connections. Particular benefits (such as netting and the resulting decrease of collateral requirements) will be impacted by the scope of assets available on the ledger. Several questions remain open in this regard, such as how exactly the right of pledge will work under DLT going forward.

**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?**

<b>Completely agree</b>	
<b>Rather agree</b>	<b>x</b>
<b>Neutral</b>	
<b>Rather disagree</b>	
<b>Completely disagree</b>	
<b>Don't know / No opinion</b>	

**Please explain your reasoning (if needed).**

EACH is of the opinion that the implementation of DLT might entail risks linked to e.g. the operational side of the clearing services that could have more wide-ranging consequences than currently faced by the industry. Glitches and failures in a DLT solution could potentially threat financial stability as DLT solutions are shared between a greater number of participants, and the interconnected and continuous nature of the system could create operational risks during deployment of system updates. Other risks that the use of DLT might pose include scalability risks (i.e. DLT providers must ensure adequate enhancements and testing of

technology as they scale operations for greater volumes and check data storage capabilities) and legal risks (i.e. uncertainty about the enforcement of transactions and conflicting rules). EACH also believes it is unclear if DLT platforms could cover the entire lifecycle of securities, and if any DLT solutions will have to continue to interoperate with other systems (which may in turn be based on DLT or other technology).

In addition, EACH would like to underline that there is a difference between public/permission-less and private/permissioned networks with regard to associated risks, although we believe it does not seem useful to delineate around permissioned or permission-less now, since it can be entirely orthogonal to the shape and function of the solution providing any of the named regulatory activities (trading, post-trade, asset management).

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 administering and managing assets for investors and, considering the financial crisis, CCPs and CSDs have proven to add significant stability to the markets. Accordingly, EACH foresees an even more important role for CCPs and CSDs to ensure trust in such a new technology.

**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.**

CCPs acknowledge that technological development is pushing the financial services industry to rethink many of its processes and structures, in order to facilitate cost reduction, and to make clearing and settlement more efficient. As these technologies advance, and are more widely adopted, they offer a more efficient means for market participants and market infrastructures to more efficiently manage their risk. In this regard, EACH would like to highlight that open market and competition should be ensured across the value chain. Due to the cross-border nature of the DLT technology, indeed, a global viewpoint and coordination that enables trading across borders is imperative. It is perhaps too early to tell how far-reaching an impact these technologies will have on how participants trade, clear and report, but development is progressing at pace.

However, EACH intends to underline that the benefits of clearing transactions through a CCP will not become obsolete in the future. In particular, we note that certain functions of the CCP, including multilateral netting, which cannot be applied as effectively or across multiple counterparties in a DLT environment, will remain unique features of central clearing even if the industry moves to a distributed ledger. The benefits of CCP clearing indeed go beyond settlement. DLT does not reduce the risk of a bilateral counterparty defaulting on obligations to its trading partners, a risk that CCP clearing reduces by guaranteeing performance of trades. CCPs additionally perform a series of risk, collateral, and default management processes that cannot be directly replaced by DLT.

**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?**

<b>Completely agree</b>	<b>x</b>
<b>Rather agree</b>	
<b>Neutral</b>	
<b>Rather disagree</b>	
<b>Completely disagree</b>	
<b>Don't know / No opinion</b>	

**Please explain your reasoning (if needed).**

EACH believe that a regulatory approach would be not only appropriate but also necessary not to stifle innovation and to carefully monitor DLT as well as security tokens developments at this time. In addition, EACH is of the opinion that a unified European approach on this issue would be suitable to avoid regulatory fragmentation and different interpretations between Members States. The regulatory solution should also include a definition of security tokens, specified in Regulatory Technical Standards if needed, and potential amendments to existing regulatory requirements, e.g. in order to address new technology-related risks. Given that this technology is new, a unified regulatory framework across the EU would help to effectively address risks, to provide for a reliable regulatory basis for business initiatives in this area and to build a Single Market. However, as previously mentioned, it does not seem useful to delineate around permissioned or permission-less at this point in time, since it can be entirely orthogonal to the shape and function of the solution providing any of the named regulatory activities.

Furthermore, EACH would like to underline that, irrespective of the underlying technology or the underlying asset classes, same services should be regulated in the same manner in order to ensure a level playing field and legal certainty, as well as guarantee the stability of the financial system. If certain aspects require additional clarification due to the underlying technology, this could be achieved in a first instance by official regulatory guidance or legal clarification.

**101) Do you think that security tokens are suitable for central clearing?**

<b>Completely appropriate</b>	<b>x</b>
<b>Rather appropriate</b>	
<b>Neutral</b>	
<b>Rather inappropriate</b>	
<b>Completely inappropriate</b>	
<b>Don't know / No opinion</b>	

**Please explain your reasoning (if needed).**

EACH believes that digital security assets representing financial instruments are suitable for clearing as CCPs would diminish any counterparty risk, provide for netting efficiencies (i.e. avoiding the necessity for instant settlement) and ensure physical settlement. As previously justified, risk management services of CCPs will still be required in the future – as the financial crisis 2008 has proven – and the G20 declaration of Pittsburgh strengthened the importance of CCPs in this context. Other crucial functions of CCPs, including multilateral netting and netting between different asset-classes, collateral and default management processes, cannot be directly replaced by DLT today. Digital securities are therefore appropriate for central clearing, and CCPs should be allowed to clear them in accordance with EMIR.

However, further clarity is needed regarding the conditions and prudential requirements with which CCPs are allowed to clear digital-assets and derivatives with a digital asset underlying. They should, in addition, qualify as eligible margins. In general, EACH is of the opinion that the relevant regulations are agnostic to the kind of systems that may be used by a CCP or a Trade Repository. It would nevertheless need to be clarified that a CCP may accept and hold digital security and payment assets for settlement and margining purposes.

The possibility of “T-instant” is no unique feature to DLT. However, currently there seems to be a majority of participants in the market preferring “T+2” due to, for instance, liquidity management reasons. Also, risks with regard to insolvency and (physical) delivery are still relevant.

Using DLT would also allow to segregate accounts and margin custody, and this should therefore be allowed by law.

**102) Would you see any particular issue (legal, operational, technical) with applying the current rules in a DLT environment? Please rate each proposal from 1 to 5, 1 standing for “not a concern” and 5 for “strong concern”.**

	1	2	3	4	5	No opinion
<b>Rules on margin requirements, collateral requirements and requirements regarding the CCP’s investment policy</b>	x					
<b>Rules on settlement</b>			x			
<b>Organisational requirements for CCPs and for TRs</b>	x					
<b>Rules on segregation and portability of clearing members’ and clients’ assets and positions</b>	x					
<b>Rules on requirements for participation</b>	x					
<b>Reporting requirements</b>	x					
<b>Other (including other provisions of EMIR, national rules applying the EU acquis, supervisory practices, interpretation, applications...)</b>				x		

**Please explain your reasoning (if needed).**

EACH believes that central clearing can be DLT processed, but at the same time it should be centrally governed, and the transfer of ownership and finality would need to be clearly provided for by applicable law: in this case, the relationship between the participant is not altered. The DLT technology should not per se fundamentally change the existing legal framework, and therefore, the use of cryptography and DLT as the only differentiator factor for crypto-assets may be considered insufficient. Also, settlement finality rules should be in line with the system finality using a DLT. Using DLT, segregated accounts and margin custodized should be enabled by relevant regulation.

In addition, EACH is of the opinion that several topics should be clarified under EMIR, for instance:

- Could CCPs clear crypto assets such as tokens representing non-regulated assets? Under what conditions? If these tokens are not defined as financial contracts, would they be subject to EMIR?
- Would derivatives whose underlying is a crypto asset be subject to EMIR? Would there be additional prudential requirements for such type of assets?
- Will market infrastructures in general, and CCPs in particular, be allowed to provide services related to access to a DLT in order to facilitate participation of all market participants?

In addition, it is important to highlight the following points related to DLT technologies where special attention should be paid and where there may be a need for additional guidance:

- Access by indirect participants in DLT environments will probably expand the role of clearing members to that related with the access and custody of public and private keys.
- CCPs need protection tools against clearing members accessing through their own node to the DLT, particularly when the clearing member shares the node with other applications.
- Neutrality should be applicable to the underlying assets.

**103) Would you see the need to clarify that DLT solutions including permissioned blockchain can be used within CCPs or TRs?**

EACH does not see the need to clarify that DLT solutions including permissioned blockchain can be used within CCPs or TRs. We rather believe it would be more necessary to focus on the clarification of the concepts detailed in the response to question 102. As already specified, EACH believes that the relevant regulations are agnostic to the kind of systems that may be used by a CCP or a Trade Repository. However, it would be important to clarify that a CCP may accept and hold security and payment tokens for settlement and margining purposes. (e.g. crypto assets should also qualify for eligible margin assets.)

**104) Would you see any particular issue with applying the current rules to derivatives the underlying of which are crypto assets, in particular considering their suitability for central clearing? Please explain your reasoning (if needed).**

EACH is of the opinion that high volatility, low liquidity and difficulties on access to reliable prices would pose additional risk on clearing this type of asset. Such risks might be mitigated by regulation and participation of financial market infrastructures.