

FESE response to the ESMA Consultations on reverse solicitation and the classification of crypto-assets under MiCA

26th April 2024

1. Consultation on the draft guidelines on reverse solicitation

Q1: Do you agree with the approach chosen by ESMA? Do you see any potential loophole that could be exploited by third-country firms to circumvent the MiCA authorisation requirements?

FESE is generally in line with ESMA's proposal on the reverse solicitation. However, the proposed requirements might be too strict. There are certain sub-outsourcing elements from the third country providers which should not be seen as reverse solicitation. There is a need for further clarification on how it would be handled if the EU CASPs use certain services from third-country firms outside the EU.

Q2: Are you able to provide further examples of pairs of crypto-assets that would not belong to the same type of crypto-assets for the purposes of Article 61 of MiCA? Or are you able to provide other criteria to be taken into account to determine whether two crypto-assets belong to the same type?

Q3: Do you consider the proposed supervision practices effective with respect to detecting undue solicitations? Would you have other suggestions?

2. Consultation on the draft guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments

Q1: Do you agree with the suggested approach on providing general conditions and criteria by avoiding establishing a one-size-fits-all guidance on the concepts of financial instruments and crypto-assets or would you support the establishment of more concrete condition and criteria?

FESE agrees with the approach that crypto-assets qualifying as financial instruments should not fall under the scope of MiCA and be subject to already existing financial market rules, such as MiFID II/R, the Market Abuse Regulation, etc. Importantly, any asset deemed as a financial instrument should be traded only on trading venues as defined in MiFID II, i.e. regulated markets, MTFs, or OTFs.

FESE supports a technology-neutral approach and believes that the categorisation of "crypto-assets" should not be based on different technical features provided by cryptography and DLT technology but on the value of the assets represented. This means that if a category of "crypto-assets" represents a financial instrument defined in MiFID II

under Annex I, Section C of the MiFID II (1)-(11), then these assets should be treated as such instruments.

If a hybrid “crypto-asset” contains elements of financial instruments (at any point of its life-cycle), it should equally fall under the scope of financial instruments’ rules (i.e. MiFID IIR etc.). However, FESE is concerned that there is much flexibility left to NCAs to conduct a case-by-case assessment to decide whether a crypto-asset would be considered a financial instrument under MiFID II. If one NCA sees certain crypto-assets as falling under MiFID II and another NCA sees it otherwise, it will create fragmentation and confusion on the application of rules. It is crucial to clarify the approach, e.g. if one NCA defines certain crypto-assets as falling under MiCA then all other NCAs should follow, or potentially ESMA should monitor it. From a legal perspective, this is a crucial point that deserves clarity.

Q2: Do you agree with the conditions and criteria to help the identification of cryptoassets qualifying as transferable securities? Do you have any additional condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

Q3: Based on your experience, how is the settlement process for derivatives conducted using crypto-assets or stablecoins? Please illustrate, if possible, your response with concrete examples

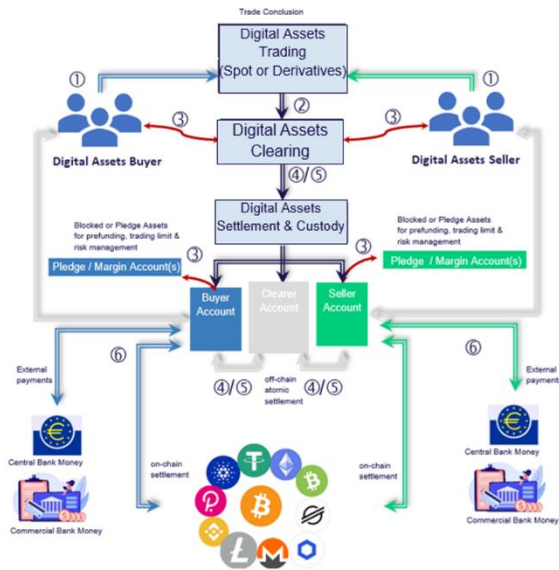
Please find below a brief explanation of the settlement process for digital assets using derivatives.

The trade confirmations for spot transactions or delivery obligations in digital assets using derivatives are forwarded to the trading participants and a clearinghouse (e.g., digital asset clearing house). This clearinghouse performs netting and offsets settlement positions (“trade date netting”) and sends the settlement instructions (incl. offset payments/deliveries) to a digital asset’s custody services provider (i.e., digital assets custodian), where the clearinghouse and the clearing members hold accounts. On the value date, settlement attempts will be initiated. In case the settlement counterparties have sufficient positions, DvP (“Delivery versus Payment”)/DvD (“Delivery versus Delivery”) settlement is performed.

At the digital asset’s custodian, settlement can be reflected as pure bookkeeping/accounting entries. This means that no settlement on a blockchain, but a book credit & debit of the respective FIAT and/or crypto assets/ stablecoins in the custody accounts of the clearinghouse and the clearing members will occur. This procedure eliminates any settlement risks likewise in the traditional world. On-chain re-alignments are only required to ensure sufficient digital assets funding on value date (i.e., prior settlement) or to withdraw digital assets after the settlement (e.g., to cater for arbitrage trading or settlement on other venues).

This process could be illustrated as follows:

Settlement of digital assets with central clearing



Pre-requisites

Ideally, the client is a direct trading member at a digital assets trading place clearing member of a digital clearing house and a client of a digital asset custodian. However, the usage of agents in any stage of the chain is possible.

Workflow

- 1) Trades are concluded on anonymized base on a digital assets trading platform.
- 2) The digital assets trading place sends transactions to a digital clearing house which gets the trade counterparty.
- 3) The digital clearing house calculates initial margins. The trade counterparty must immediately move the respective collateral to the pledge account in favour of the digital clearing house. The digital asset custodian is confirming the pledged assets as soon as they are firmly settled.
- 4) The digital clearing house calculates variation margin & option premium. Payment requests are sent to the digital clearing house. The amounts are directly debited from the clients main/source account. The digital clearing house is confirming as soon as the payment has settled.
- 5) Prior/On settlement date, the digital clearing house sends the respective settlement instructions to the digital asset custodian. Clients must have the respective assets in their account with the digital asset custodian. The atomic settlement is performed in form of a book entry w/o blockchain involvement.
- 6) Realignment with the blockchain (Crypto) or central / correspondence bank (FIAT). Clients need to dispose / instruct in advance to ensure that crypto/FIAT assets are available on their settlement accounts when needed (i.e., on valuation date). In- and outgoing payments/deliveries are timely decoupled from settlement obligations. Outgoing payments can be instructed anytime but executed based on the available/settled and unpledged balance. Realignments or settlement of OTC transactions with a counterparty that uses also DBDS are as well "atomic settled", i.e., in form of a book entry w/o blockchain involvement.

POA – Power of Attorney

The settlement in a stablecoin would be treated like the delivery of asset “A” against receipt of asset “B”, where asset “A” could be the stablecoin while asset “B” is any other (digital) asset that the digital asset custodian supports.

Q4: Do you agree with the conditions and criteria to help the identification of cryptoassets qualifying as another financial instrument (i.e. a money market instrument, a unit in collective investment undertakings, a derivative or an emission allowance instrument)? Do you have any additional condition, criteria and/or concrete examples to suggest?

Q5: Do you agree with the suggested conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets? Do you have concrete condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

Q6: Do you agree with the conditions and criteria proposed for NFTs in order to clarify the scope of crypto-assets that may fall under the MiCA regulation? Do you have any additional condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples

Q7: Do you agree with the conditions and criteria proposed for hybrid-type tokens? Do you have any additional condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

FESE agrees with the hierarchical approach for hybrid-type tokens' classification. When crypto-assets have characteristics of financial instruments, these characteristics should take precedence in the classification.

Nonetheless, FESE calls on ESMA to further clarify this approach with regard to the hierarchy of properties to avoid any confusion or diverging classifications and ensure EU-wide harmonisation. In line with that, we are of the view that a minimum amount of financial instrument properties should suffice to classify an asset as a financial instrument falling under MiFID II.

Furthermore, as some jurisdictions recognise security tokens as a category, and seeing that no equivalent recognition exists on the EU level, we call on ESMA to clarify how the situation in which two jurisdictions do not recognise the same categories would be resolved. In this case, it is crucial to establish a clear process to avoid uncertainty.