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Strengthening the Capital Markets Union through wholesale digital markets
Proposal for a legislative package for the new EU mandate

Digital finance use cases Working Group Position Paper

Paris Europlace is the organization in charge of promoting and developing the Paris financial center. We are a privileged intermediary of European and French authorities, with which we maintain a continuous and constructive dialogue. Our aim is to promote financial markets to international investors, issuers and financial intermediaries to better finance the real economy and the energy transition. Paris Europlace gathers more than 600 members, including investors, banks, financial market authorities, corporates and consulting firms. The work Group "Digital Finance and Use Cases" gathering the financial ecosystem around digital innovation is proposing the following recommendations.

The Capital Markets Union in the European Union is an ambitious objective but unfortunately several obstacles still prevent its full realization, in particular (i) the fragmentation of European markets which limits their liquidity and efficiency, (ii) regulatory divergences between Member States, or (iii) the lack of interoperability of European financial market infrastructures.

However, the Draghi[1] report showed that the key driver of the rising productivity gap between the EU and the US has been digital technology ("tech") - and Europe currently looks set to fall further behind. An important reason EU productivity diverged from the US in the mid-1990s was Europe's failure to capitalize on the first digital revolution led by the internet - both in terms of generating new tech companies and diffusing digital tech into the economy.

To address this productivity gap, the European economy needs to better integrate new technologies. In certain areas of the financial sector, the adoption of blockchain or distributed ledger technology (DLT) could offer the potential for very significant productivity gains due to the automation of market transactions and of the back offices of financial institutions.

We believe that as the European Union further develops its Capital Markets Union roadmap, it should foster the development of wholesale digital markets. The development of new digital markets in Europe with the appropriate regulatory framework is also essential to ensure European economic sovereignty over the new markets that are emerging. It is also

[1] 97e481fd-2dc3-412d-be4c-f152a8232961_en (europa.eu)

essential to bring the benefits of blockchain technology to the real economy by broadening the sources of financing of the dual transition and creating employment.

In our view, the EU support should take the form of a **wholesale digital markets legislative package** consisting of 5 pillars:

1) Foster the development of DLT wholesale market infrastructures by expanding the pilot regime
2) Facilitate the integration of DLT technology in financial institutions by adopting an appropriately balanced prudential regime
3) Support monetary digitalization through a wholesale central bank digital currency which would interact with tokenized commercial bank money
4) Foster the digital transition of European financial markets by supporting tokenized public debt issuance using DLT technology
5) Promote standards for interoperability between new infrastructures and existing infrastructures for securities and payments.

1/ Encourage the development of DLT wholesale digital market infrastructures by expanding the pilot regime

The EU Pilot Regime Regulation [2] is an excellent initiative, positioning the EU at the forefront of financial innovation. However, it struggles to find candidates at this stage[3] due to certain restrictions. At the same time, other jurisdictions like the UK are following the path of the EU by creating their own Digital Sandboxes, creating more competition for EU players.

In order for the pilot regime to allow the development of significant market infrastructures at the European level, which would strengthen market integration, it needs to be amended on five points:

1) **The thresholds on the volume of tokenized financial instruments issued and traded should be increased or removed**. Currently, the level at which these thresholds are set makes the cost-benefit balance of projects strongly negative and do not allow the creation of viable business products and services that are significant enough to have a European industrial impact. At this stage, they allow only smaller projects to emerge that match partially the large-scale ambitions of strengthening productivity gains and European sovereignty.

2) **The list of financial assets eligible to the pilot regime should be extended to all financial instruments.** Currently, only shares, simple bonds and some units of collective investment schemes are covered by the pilot scheme. This list should be extended to all financial instruments, including structured products (like warrants,

[2] Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructure based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU (Text with EEA relevance)
[3] ESMA75-117376770-460 Letter to EU Institutions on DLT Pilot Regime (EN)

certificates or structured EMTNs) and derivatives. The potential complexity of a product is already covered by Prospectus Regulation and PRIIPs and the Pilot Regime should stay technologically neutral and should select a range of products based on their economical characteristics. Building really competitive digital market infrastructures means creating not only spot markets but also derivatives markets and offering products, including complex ones, that are commonly traded on traditional markets.

3) **The current six-year limit has to be extended in order to give participants in the pilot regime greater long-term stability and predictability to launch innovative projects**. Even if the Letter from the European Commission to ESMA of May 2024[4] clarifies that there is no expiration date to the pilot regime, it would be nevertheless clearer to inscribe it directly in the Regulation to remove a pain point that blocks large-scale initiatives requiring months of technical development and regulatory processes to obtain the appropriate licenses.

2/ Facilitate the integration of DLT technology in financial institutions by adopting an appropriately balanced prudential regime

Currently, the prudential regime applicable to financial institutions holding tokenized assets is subject to transitional provisions in CRR[5]. This transitional regime needs to be reviewed in the coming years. In order to develop sovereign wholesale digital markets in Europe, it is essential that financial institutions should not be prudentially penalized in their activities related to tokenized assets.

In reviewing the prudential regime applicable to tokenized assets, it is essential that:

- **The principle of technological neutrality is respected**, i.e. the underlying technological nature of the DLT used should not be a criterion that impacts prudential requirements, only if the technologies used offer the same level of security and resiliency. For example, **permissioned and permissionless DLT should be treated in the same way from a prudential perspective if they are able to offer the same level of security and resiliency**. If this is not the case, the entire European industry risks being oriented towards a technological solution which may well prove to be the least effective in terms of productivity in the long term, which will create a competitive disadvantage compared with other non-European industries.

- **The "same activity, same risk, same regulation" principle must be respected, i.e. the prudential provisions of financial instruments issued on DLT must be equivalent to**

[4] Letter from the European Commission on the DLT Pilot Regime Implementation

[5] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

that of financial instruments issued outside DLT, whether they are tokenized financial securities or tokenized cash.

- **The prudential treatment of cryptoassets must not inappropriately penalize financial institutions**, in order to enable them to develop offers in line with market trends and investor demand, as demonstrated by the ETFs recently launched in the United States.

3/ Support monetary digitalization through a wholesale central bank digital currency which would interact with tokenized commercial bank money

Strengthening of the CMU through the development of wholesale digital markets involves tokenization of both the securities leg of transactions but also the cash leg to allow the settlement and delivery of financial instruments on the same underlying technology.

The development of wholesale digital markets makes it indispensable to use a wholesale digital euro issued by the Eurosystem, in order to secure securities settlement and ensure financial stability. **The EU should reaffirm its commitment to developing a wholesale CBDC using DLT**. In the short term, and subject to case-by-case approval by the competent authorities, the use of other forms of tokenized liquidity issued or guaranteed by a bank (e.g. tokenized deposits, EMTs,…) for appropriate use cases could be envisaged in order to kick-start the development of wholesale digital markets.

Additionally, **eligibility of tokenized financial instruments as collateral for refinancing operations (repo) with the Central Bank should be ensured**, in order to implement technological neutrality and to guarantee that tokenized instruments have the same value as traditional assets.

4/ Foster the digital transition of European financial markets by supporting tokenized public debt issuance using DLT technology

The EU should support the development of a European wholesale digital markets industry by issuing bonds on a regular basis using DLT technology for both delivery and settlement.

The European Investment Bank has been a pioneer in Europe in issuing bonds on the blockchain.

In order to drive the financial industry towards more efficient digital markets, **European institutions should consider a regular bond issuance program using DLT: these could notably include the European Union through the NextGenerationEU program, the European Investment Bank, the European Financial Stability Facility, the European Financial Stability Mechanism.** Such a program would allow European institutions to support the development of a sovereign strategic industry and the creation of pan-European market infrastructures, while benefiting of lower costs and execution speed linked to blockchain technology.

This program should provide that issuances would be:

- **Regular, announcing several issuances over a certain number of months, and not only one-offs as it is the case currently,**
- **Significant, to avoid a lack of liquidity and a lack of interest for large clients.**

European institutions should also encourage national governments or other sub-national entities to issue bonds on blockchain to foster the development of a sovereign digital financial industry.

5/ Promote standards for interoperability between new infrastructures and existing infrastructures for securities and payments

With the creation of tokenized assets and money using DLT technology however, there is a risk of fragmentation between new DLT wholesale market infrastructures and existing financial market infrastructures. Therefore, to support the creation of liquidity in tokenized assets in European wholesale digital markets, **the EU should promote interoperability between new infrastructures and with existing infrastructures for securities and payments, both at an operational, technology and legal level**.

Specifically, this could involve the:

- **Adoption of solutions that can link technology platforms together** (such as those platforms hosting tokenized assets and those hosting digital money for the cash leg),
- **Ensuring that securities participants can re-use their existing forms of connectivity** as a 'single point of access' to reach new wholesale digital markets based on DLT technology, to ease adoption and enable those markets to scale their volumes,
- **Adoption and promotion of standards covering interoperability and connectivity**, together with other key topics such as resilience, security and operational scalability, for example as outlined in the recently developed Digital Assets Securities Control Principles (DASCP)[6].

The EU should support the adoption of solutions that enable interoperability, to ensure that securities participants can re-use existing connectivity to reach new wholesale digital markets, and to **promote standards for interoperability and connectivity**.

[6] Digital Assets Securities Control Principles whitepaper, Euroclear.com