German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Additional comments

on the "proposal for a regulation on markets in crypto assets" as part of the European Commission's Digital Finance Package

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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With reference to our comments on the "proposal for a regulation on markets in crypto assets" as part of the European Commission's Digital Finance Package dated 16 October 2020, we wish to make the following additional comments on the proposed legislation:

Stability of the commercial bank money system:

Liquidity in the EU economy is provided in a two-tier monetary system: the ECB supplies the public with cash as the sole legal tender and banks provide commercial bank money granting credit. Commercial bank money is the common electronic representation of money. It is credited to payment accounts and in retail and wholesale customer business transferred in exchange for goods or services. At present, Commercial bank money accounts for a large part of most national currencies.

Because of this key role to provide the economy with liquidity, the banks are highly regulated and must comply with a whole set of obligations, which include the maintenance of minimum reserves, the fulfilment of minimum capital requirements and the compliance with the requirements of the EU Deposit Guarantee Schemes Directive.

In order to contribute to further progress in digitalisation and to strengthen the competitive position of the EU economy, banks are increasingly examining possibilities of providing commercial bank money in a cryptographic infrastructure (particularly to enable the programmability of money) and to integrate them in the existing EU payment ecosystem. Enterprises in the entire EU are examining business cases in which the programmability of money is a key requirement.

The MiCA draft regulation excludes so-called "crypto-assets" that count as bank deposits from the scope of application (Art. 2 (2c)). Here, the draft regulation, as with regard to the financial instruments, assumes that this area falls under the existing regulation. From the perspective of the banks, however, this approach leaves a lingering legal uncertainty about whether the existing regulation does in fact enable the commercial bank money system to be applied to a cryptographic infrastructure.

In our view there are two ways to eliminate the legal uncertainty in this area: First, within the existing legal framework for bank deposits, it could be clarified that deposits based on a cryptographic infrastructure also qualify as such. Alternatively, a specific category for token-based commercial bank money could be created in the MiCA regulation itself. The e-money token envisaged in the draft MiCA regulation is not suitable for this, as it assumes key elements of the e-money directive. The safeguarding requirements to be met by e-money issueres have always made it unattractive for banks to establish a sustainable business model based on e-money. Based on the current draft, this would apply to "e-money tokens" too. Also, the prohibition of interest (Art. 45) would act as a hindrance in the demand deposit system.

Basic questions in connection with crypto-assets within the meaning of MiCA:

Among other things, the draft regulation sets out detailed requirements for the issue of crypto-assets and regulates crypto-asset providers. In connection with crypto-assets, there are, however, **basic issues** which have not been clarified even at national level, at any rate not entirely. In order to establish general legal certainty for users of systems based on DLT, clarification of such fundamental issues is required, however.

1. There is thus currently legal uncertainty regarding the legal classification of various crypto-assets. In cases in which by means of crypto-assets claims/receivables against an issuer are generated, the legal principles of obligation would apply to the creation of, and disposition over, these claims. In our view, this will always be impracticable for trade deals with crypto-assets, especially where multilateral trading is to be established, such as in markets with crypto-assets. Reason: contractual dispositions (via assignment), for example, know no good faith, and in the event of insolvency of a "custodian" party the ownership rights to the receivables are not enforceable. Because of their lack of physical form, under German law, crypto-assets are basically not regarded as chattels either, and in the generation of, and disposition over, such assets – unlike securities, for example - do not even comply with the principles of property law, which would offer advantages regarding good-faith protection and safeguard against insolvency. Also, under German, and even EU law, there is at present no singular category with its own transfer rules, e.g., a "crypto-assets law sui generis". Precisely for crypto-assets, where data are an essential criterion but do not "tokenise" claims against an issuer, moreover, there arises the question how they are to be defined under civil-law and how they can be transferred. Under German law there is at any rate no ownership of data. Even under international law, the issue of data ownership is highly contentious.

The civil-law classification, however, entails legal consequences and is always a reference point for other legal classifications, e.g., in tax and accounting law. The prevailing legal uncertainty should be dealt with at European level. Only in this way can the envisaged single market for crypto-assets in Europe be realised. In order to be able to create EU-wide uniform regulations, a wide-ranging discussion on the legal classification of crypto-assets in the Member States and at EU-level is first of all necessary. The Principality of Liechtenstein, for example, has passed a special Block Chain Act to engender "legal certainty and trust in the token economy". Whether and to what extent such a law or laws in other Member States can be the starting point for the German or European lawmaker or whether these laws lead to a fragmentation of legal rules in the EU must in our opinion be subject of a more in-depth analysis. In this context, we would also like to draw attention to the EU Commission's years-long efforts to harmonise securities law legislation.

2. There continue to be application and regulation issues with regard to DLT platforms (such as Corda, Hyperledger or Ethereum) on which crypto-assets are registered. As correct and important the regulation of crypto-assets with the draft MiCA regulation is, it appears right to lay down minimum criteria for the operation of DLT platforms for crypto-assets. This applies, for example, to liability issues, dealing with cyber-attacks, handling errors in the block chain and programming codes etc.

By means of a clear legal framework, minimum standards for DLT platforms can be developed by market participants, which would result in further legal certainty both for issuers of crypto-assets and users of these crypto-assets. This as well as the regulation announced in Germany for legislation on the introduction of electronic securities (e-WpG = German abbreviation) could also serve as an orientation for DLT platforms for crypto-assets.

Comments on individual provisions of the draft regulation:

1. The European Union is starting early to establish a legal framework for crypto-assets. Here, we see the opportunity for the EU to assume a leading role in setting a global standard. In view of this, MiCA should be compatible with the recommendations for crypto-assets from international supervisory and regulatory bodies (such as the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB)) and the already established global standards of international standard setters.

In addition, the regulation of crypto-assets should take into account the deliberations of the European Central Bank for a digital euro.

2. In order to live up to its aspiration of being a regulation assured of a good future and technology-neutral, it should not be tied to DLT technology. Tokens which are stored in another fashion than in a data bank (or similar) are not included in the regulation.

3. The definition of a DLT in Art. 3 (1) (1) MiCA ("a type of technology that support[s] the distributed recording of encrypted data") is not in line with the general understanding of DLT. Existing DLT-based crypto-assets, for example, such as Bitcoin and Ethereum, are not included, as these crypto-assets are not "encrypted". If MiCA is confined to DLT, at least a definition of DLT should be used that better reflects the general understanding of DLT; in particular, "encryption" should be dropped from the definition.

4. In Art. 3 and Title V MiCA, "payment services" should be included as a crypto-assets-service. Minimum standards (e.g., in accordance with the regulations of the PSD2 directive) should be laid down for these payment services so that both classic payment transfer business and payment transfers based on tokens are regulated.

5. MiCA should be harmonised as far as possible with the existing regulations (such as the E-money Directive (EMD2), the PSD2, MiFID II), for example:
    a. The regulatory incremental value of a stand-alone and stricter regulation of e-money on a DLT basis in comparison with classic e-money is not evident. It is, for example, planned that e-money providers on a DLT basis must publish a white paper, which until now has not been the case with e-money. Should the approach of a stand-alone regulation actually be necessary, it should at least be ensured that apart from that the E-money Directive and the MiCA provisions for e-money tokens (EMT) are as consistent as possible.
    b. Art. 37/38 MiCA: The acquisitions of issuers of asset-referenced tokens follows the rules in MiFIDII and the EMD2. In MiCA, however, a qualified holding already starts at 10%, whereas in the PSD2 (Art. 6 (1)), EMD (Art. 3 (3)), MiFIDII (Art. 11 (1)), a qualified holding does not begin until 20%. MiCA should not deviate from the aforementioned regulations.
    c. Art. 74/75 MiCA: The same applies to the acquisition of service providers.

6. It should be checked to what extent current regulations – such as in the money laundering directive (AMLD) (e.g., uncertainties about the required KYC-procedures for clients which in turn issue utility tokens to their clients); the directive on managers/administrators of alternative investment funds (AIFMD), the regulation on European Long-Term Investment Funds (ELTIF), the UCITS directive (in this context it is conceivable, for example, that the management/administration of the reserves of stablecoins is to be seen as a type of investment fund/falls under the current concept of portfolio management; should the existing licencing procedures then apply?) - are compatible with MiCA or must be amended if necessary.

7. Art. 3 MiCA: The definition of asset-referenced token (ART) and EMT should be aligned with the recitals. In the recitals, EMT is described as a "means of payment" and ART as a "means of exchange". In Art. 3 MiCA, on the other hand, EMT is described as a "means of payment" and for ART there is no purpose mentioned. In addition, there should be a more detailed description of what is meant by "means of payment" and "means of exchange". The understanding in each case is unclear.

8. The distinction in para. 9 of the recitals is incomplete: A) crypto-asset on a DLT basis (=utility token) = non-financial purposes, B) asset-referenced tokens referencing several currencies, C) means of payment in a nominal currency. There are possible contradictions here regarding the digital euro presently under discussion. There must be clearer definitions which variation, for example, a bank-issued token with a DLT connection in a currency (= value-stabilised) belongs to.

9. Art. 33 (8) MiCA: The planned liability for financial instruments or crypto-assets held in custody as reserve assets is replicated on liability as defined in UCITS and AIFMD. "Custodians" of these reserve assets, however, do not assume any further functions over and above that of the pure function of custodian, such as would be usual for depositaries of investment funds, e.g., control functions. MiCA should therefore not introduce any new liability rules for these custodians which would deviate from the usual regulations for custodians. This is particularly relevant in view of the fact that certain crypto-assets, e.g., such as are not brought to market by an issuer, will in future not be regulated either. Art. 33 (8) MiCA could, however, mean a liability for the custodian for a "loss" of these unregulated instruments.

10. In our opinion, the calculation basis for the capital requirements of issuers of crypto-assets/stablecoins should for reasons of competitive equality be comparable with those for credit institutions (CIs). This is not the case for the 2% (and/or 3% for significant asset-referenced tokens) mentioned in the draft. This problem could be resolved in an easy way in line with the regulations for the calculation of capital requirements for securities firms that are subject to the CRR. Such securities firms must basically maintain 25% of the preceding year's fixed overhead costs as own funds (Art. 97 CRR). They do, however, have to compare this amount with the capital requirements for CIs (Art. 92 (3) a) to d) and f) CRR, Art. 95 (2) CRR). Relevant for the capital requirements is thus always the higher amount. This should, in our opinion, also be applied to the issuers of crypto-assets/stablecoins – these too should perform a comparison calculation with the capital requirements for CIs and in each case apply the higher amount. In this way, a corrective would be created in the event that the 2% and/or the 3% were incorrectly calibrated.

11. Art. 42 MiCA: The intention is that issuers of ARTs draw up an appropriate plan for an orderly resolution. From a risk perspective, it appears necessary that this be required of crypto-assets-service providers along the same lines too.

12. Art. 63/67 MiCA: The significance of "safekeeping", "custody" and "administration" of crypto-assets should be explained in the recitals. At the moment, how these terms are to be understood in relation to crypto-assets is unclear.

13. Art. 66 MiCA: MiCA proposes regulations for outsourcing by service providers of crypto-assets, but not by the issuers. Issuers too have numerous possibilities to outsource, so that here too appropriate regulations are necessary.

14. Art. 99/101 MiCA: Supervision/regulation by the EBA is planned for the issuers of significant ARTs and EMTs. Here, it must be ensured that with institutions which based on other regulations are already supervised/regulated (e.g., by the ECB and/or national regulatory bodies), there is no contradictory supervision/regulation. Apart from that, we consider the proposals for the supervision of issuers of significant asset-referenced tokens and e-money tokens reasonable.

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