Draft Regulatory Technical Standards to specify the highly liquid financial instruments with minimal market risk, credit risk and concentration risk under Article 38(5) of Regulation (EU) 2023/1114

Question 1. Do respondents have any comment on the list of eligible highly liquid financial instruments provided under point (c) of Article 1(1) of these draft RTS?

In our opinion, the definition of highly liquid assets does not account for liquid assets held in an insolvency protected structure erasing counterparty risk; for instance, a fiduciary structure involving escrow accounts at central banks of member states (e.g. in accordance to Luxembourg law). These accounts are on the one hand also highly liquid and on the other hand are not exposed to market risks or credit risks. An addition of such assets to the definition of level 1 liquid assets is needed for operational purposes, as e-money issuer will only have access to central bank accounts if they simultaneously hold a license as credit institutions as central banks will not grant accounts to institutions which are not credit institutions. All other E-money issuers need to be onboarded by other third credit institutions which then hold escrow accounts at central bank. The structure involving fiduciary services and escrow accounts described above will enable e-money issuer to achieve the same security in regards to credit and concentration risks which is possible for credit institutions.

Moreover, as there is no credit risk, also the limits in regard to concentration risk of credit institutions should not apply in such cases. In our opinion it therefore would be reasonable to give the opportunity to the national supervisory authorities of a respective issuer to grant exceptions of these concentration risk requirements if the issuer can demonstrate that there is no counterparty risk involved for the storing of cash reserves.

In addition, as issuers not being credit institutions are currently not able to access national central bank accounts directly, it would be reasonable to consider this possibility.

Furthermore, in our opinion and in accordance with Article 38.2 of the Regulation (EU) 2023/1114, level 1 highly liquid assets should also include UCITS that only invest in level 1 highly liquid assets themselves as these UCITS are also deemed to be assets with minimal market risk, credit risk and concentration risk.

Question 2. Do respondents have any comment on the general and operational requirements to be met by highly liquid financial instruments provided under points (a) and (b) of Article 1(1) of these draft RTS? Please explain if some criteria is expected to be challenging to be met in practice.

The general requirements in accordance with Article 1.1 (a) and the operational requirements in accordance with Article 1.1 (b) are clear. However, our comments to question 1 need to be taken into account for the classification of Level 1 liquid assets.

<u>Question 3. Do respondents find the treatment for hedging derivatives under Article 2 clear to be applied?</u>

The treatment for hedging derivatives is clear.

<u>Question 4. Do respondents think that the draft RTS create any impediment for issuers to ensure a good control of the correlation between the highly liquid financial instruments and the assets referenced? This is particularly relevant for the case of tokens referenced to assets other than official currencies.</u>

Yes, in our opinion, the RTS creates impediments for issuers to ensure a good control of the correlation between the highly liquid financial instruments and the assets referenced. Especially, due to the concentration limits given in general and also in accordance with Article 3 a). The instruments mentioned in Article 3 a) are not subject to any haircut as these are seen to be highly secure. Limits on concentration risks, will complicate the operational asset management of e-money token issuer in regards to

a) complying with the regulatory concentration limits,
b) complying with the over-collateralization requirement, and
c) operating sustainable in regards to its own income and costs, especially due to the fact if the requirements will be enforced as currently proposed, e-money institutes will need several counterparties which will create additional costs and reduce income (e.g. in form of interests on cash reserves).

Furthermore, in our opinion, there should not be a limit in regards to concentration risks of single entities or entities with close links for highly liquid assets (level 1) assets as there is no or negligible credit risk – especially for instruments such as instruments issued by creditworthy governments (based on their credit rating). From our understanding, not having a limit in regards to concentration for level 1 assets without haircut it would also be in line with table 1 “Categories of liquid assets in the LCR” (page 31) as there the cap for each individual Level 1 liquid assets in regards to concentration limits is set as “none”.

<u>Question 5. Do respondents have any concern about the feasibility for issuers to have the minimum amount of reserve of assets considering the list of eligible highly liquid financial instruments, the one-to-one currency matching requirement in Regulation (EU) 2023/1114 and the concentration limits under Article 3 of these draft RTS? This is particularly relevant for tokens referenced to official currencies.</u>

In our opinion, there need to be a distinction between issuers being credit institutions and issuer not being credit institutions. In contrast to issuers being credit institutions, issuer not being credit institutions are much smaller firm and can hardly build up operational processes to comply with all requirements while working economically. Credit institutions on the other hand, have these operational structures in place. For issuers not being credit institutions complying with the eligibility of available assets, the one-to-one currency matching requirements and the concentration limits under Article 3, creates a very high impact on the operational and risk management processes (for instance after redemptions or during reconciliations).

In addition, despite not related to the concentration of securities mentioned in Article 3, we are very concerned about the concentration limits of cash reserves hold in credit institutions in accordance with Article 5 of the Draft Regulatory Technical Standards to further specify the liquidity requirements of the reserve of assets under Article 36(4) of Regulation (EU)

2023/1114, especially as these limits do not account for situations in which e-money issuers are willing to hold more than the minimum amounts of reserves in form of cash. Given the current limits (especially of holding 10% at one credit institution), will require a e-money institute that wants to hold cash only to have at least eleven credit institutions for

a) the starting period before reserves are invested in securities, and
b) an investment strategy of holding 100% reserve in cash to eliminate market risks.

Especially, due to the fact that there are not many crypto friendly banks within the sector, this number of credit institutions is not feasible to be obtained by a e-money issuer. The 10% limit per credit institution might also force e-money issuers to use banks for the reserves that have a worse credit risk. The tradeoff between the specific credit risk of credit institutions versus the concentration risks is in our opinion not taken into account sufficiently.

Furthermore, we are referring to our previous answers, especially the answers to questions 1 and 4.

Question 6. Do respondents have any concern about the operational feasibility of the look through approach envisaged in paragraph 3 of Article 3 of these draft RTS? If yes, please elaborate your answer and specify the reasons for the concerns.

From our understanding paragraph 3 of Article 3 is not in accordance with Article 38.2 of the Regulation (EU) 2023/1114. From our understanding of the Article 38.2 a look through approach is only required during the setup of a UCITS but not continuously during operations if the requirements of Article 38.2 are fulfilled in regards to market risks, credit risks and concentration risks.

If there is a misunderstanding in the aforementioned on our side, we are nevertheless concerned about a look through approach due to the fact that:

a) Portfolio data of CIU is only feasible ex-post on the basis of their publicly available reports, so that there is always a time gap between today and the last information provided. This could result in the fact that there are concentration risks currently available which however are not represented based on the available data. This “supposed security” might lead issuers to wrong conclusions.
b) It is operationally not feasible to automate limits in regards to look through concentration risks. Therefore, a lot of manual controls would be needed which
    i. increase the issuers costs in back office processes including portfolio management, risk management and operations
    ii. is prone to errors, and
    iii. as stated in a) an ex-post evaluation.

Question 7. Do respondents have any comment with regards to the unwind mechanism proposed under Article 4 of these draft RTS and the related examples provided?

We do not have comments on the proposed unwind mechanism.

Question 8. Do respondents have any general comment about the interaction of these draft RTS with the business model and the continuity of the business of these activities?

Please see our answers to the questions above.

Moreover, in our opinion, there especially need to be a distinction between issuers being credit institutions and issuer not being credit institutions. In contrast to issuers being credit institutions, issuer not being credit institutions are much smaller firm and do not have the possibilities credit institutions have such as their access to capital markets or central banks. For such issuers, it is hardly feasible to build up operational processes which comply with all requirements while working economically. Especially the cumulative effect of several requirements such as the limitation of eligible assets, the one-to-one currency matching requirements and the concentration limits under Article 3, create a very high impact on the operational and risk management processes greatly impeding an economical business model.

In addition, even not directly related to the Articles mentioned, the RTS will also operationally impede the issuers largely due to the concentration risk of holding reserves in form of cash. As issuers are required to have at least four credit institutions (if cash is held by only 30%) but up to eleven credit institutions (if cash is held by 100% and limits should not be fully used for operational purposes), operations are currently created highly complicated and very likely not feasible at all, as only a few crypto friendly credit institutions are available in the market. In fact, even four credit institutions to be onboarded by an issuer is hardly feasible (not taking into account the heavily increased costs associated with the setup of that many partners). In addition, crypto friendly credit institutions tend to be smaller institutions with less assets on its balance sheet. For this reason, the restriction that the reserves held at each credit institution is not allowed to exceed 2.5 percent of the total assets of the credit institution aggravated the problem.

Compared to regular e-money issuers, the current RTS requirements (including other consultation papers currently discussed such as the Draft Regulatory Technical Standards to further specify the liquidity requirements of the reserve of assets under Article 36(4) of Regulation (EU) 2023/1114) will put a large disadvantage to e-money issuers that issues e-money token, since regular e-money institutions do not face capital reserve requirements as given in the current consultation papers.

Question 9. Do respondents find any provision in these draft RTS confusing or difficult to understand?

The extremely high complexity of the draft rules requires extensive legal, compliance-related and operationally related resources which may greatly impact the business case of issuers.

Question 10. Do respondent have any comment on the impact assessment provided?

We have no comments on the impact assessment.