Background

The World Federation of Exchanges (WFE) is[1] the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructures, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~20%). with everything from local entities in emerging markets to groups based in major financial centres. Collectively, member exchanges are home to nearly 53,000 listed companies, and the market capitalisation of these entities is over $95 trillion, while the 50 distinct CCP clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up $1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise financial stability, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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Response to questions:

Q1. Please provide any general observations or comments that you would like to make on this call for evidence, including any relevant information on you/your organisation and why the topics covered by this call for evidence are relevant for you/your organisation.

The WFE welcomes the European Commission's goal of enabling innovation through technology, particularly the ability for MIs to list and clear financial instruments using Distributed Ledger Technology (DLT). As a result, we endorse the proposal to include DLT securities and derivatives in the MiFID/ MiFIR financial instruments definition. Considering that anything that amounts to a financial instrument should be treated as such, it is vital for the purpose of level playing field and market integrity that a technology neutral approach is adopted. We consider that the primary advantage of a DLT Pilot Regime is its capacity to bring together DLT activities in a regulated environment where appropriate. Hence, as a basic argument, we believe that 'same business, same regulation' principles should be followed to maintain the pillars of investor protection and market integrity.

Q6. Instrument status: Do DLT financial instruments have different characteristics than 'standard' shares, UCITS-ETFs and bonds? If yes, please elaborate and explain whether these different characteristics call for a different approach for the application of the transparency requirements?

The WFE agrees with the proposed definitions. Some DLT based instruments may have characteristics of financial instruments, as well as characteristics of other payment instruments. With that in mind, it is important to capture those instruments that have any characteristic of a financial instrument, irrespective of whether they have a DLT component. Furthermore, the pilot points to the possibility of non-institutional participants having access to DLT MTFs. We appreciate the position whereby retail investors are not automatically barred from participating in the pilot regime, but we think that policymakers should consider the possible implications of this proposal and guarantee suitable protections.

Q7. Transactions: Where are DLT financial instruments traded? Could there be OTC trading in those instruments?

Considering that DLT instruments are traded on a shared ledger, the proposed pilot appropriately incorporates thresholds for determining whether financial products can be admitted to an MTF. It also imposes a limit on the overall market value that a DLT MTF can record. Hence, OTC trading in the proposed regime is not just possible but likely – and possibly quite attractive to some participants, as is true with other financial instruments. And, as with other financial instruments, there then arises the question as to the transparency that should apply to non-venue transactions. This Regime, in our judgement, should be developed in such a way that it poses low risks, to safeguard financial market participants and preserve market integrity.

Because DLT MTFs would be allowed to perform some activities normally performed by other financial market infrastructures, the same level of safeguards as in the current regulatory environment should also apply. Fair, cross-border access to those providing services into the EU should apply, just as access to other markets for EU-based providers should. In the case of potential exemptions for DLT-based providers from rules that would apply to providers using other technology, the policy seems to stray from technology neutrality into discrimination in favour of DLT. This does not seem justified and should be monitored extremely carefully and reviewed at the earliest opportunity, in the interests of a level playing field. In this context, more specifically in the case of permissioned systems, the importance of centralised governance should not be neglected, as it is key in ensuring accountability among participants.

Furthermore, we would like to emphasize that the DLT Pilot Regime should be, as the name points out, a pilot. The focus should be on maintaining a level playing field for existing market participants regarding innovative technologies without establishing a more favorable, "parallel regime".

Q41. What do you consider are the phases of a DLT transaction? At what point in time can such a transaction in DLT securities be considered executed? How do you think "broadcast the transaction to the network" should be defined?

Given that 'DLT transactions' in what amount to financial instruments should be treated no differently from any other transaction (ie, in securities or derivatives), the same standard should apply in terms of determining when execution has occurred and cannot be reversed. In other words, a lower standard of finality should not prevail, simply because different technology is used. Moreover, there should be the same legal standard as to authority to enter a contract, rather than relying on a 'code as contract' concept.

In the context of payment, clearing, and settlement, the phases of a DLT transactions are defined by the procedures and protocols to carry out transactions without necessarily relying on a central authority to maintain a single, main copy of the ledger. Hence, a transaction in a DLT would be considered executed when settlement finality has occurred; when an obligation by a transfer of funds and a transfer of securities that have become irrevocable and unconditional has been discharged. It is important to mention as well that, if a DLT MTF engages in such operations, the same degree of protections that exist in the present post-trade environment should be maintained. This means ensuring pre-post-trade transparency: what is about to be traded as well as what has been traded at what price.

Q42. Do you think the definition of "transaction" is still applicable to the DLT context?

DLT includes permissioned private ledgers which are suited to uses where the integrity of the market place is paramount, notably in public markets. Hence, participants in permissioned private ledgers are known to each other and the set of users who have the right to validate transactions is restricted. This promotes certainty, which is a vital component of defining a 'transaction'.

The WFE believes the EU should also aim to promote a consistent idea across the EU (and ideally, through international standards fora, globally) as to what a financial instrument is.