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Additional Information

Level 1 Regulation
Regulation (EU) 2022/858 - DLT Pilot Regime Regulation (DLTR)

Topic
DLT financial instruments

Subject Matter
Partially tokenised financial instruments

Question
Is partial tokenisation allowed under the DLTPR? Does the DLTPR apply to situations where not the entirety of an issuance of financial instruments is tokenised, but where, for example, only part of an issuance is registered with a DLT SS/TSS? In other terms, can financial instruments which have been regularly issued and subsequently partially tokenised be registered with a traditional CSD in their entirety, and be partially registered with a DLT

SS/TSS for the tokenised portion?

Can the tokenised part be issued by another party than the issuer of the original financial instruments?

Can a financial instrument recorded in a traditional CSD be fungible with one recorded in a DLT SS/TSS (having both the same rights and obligations)?

For bonds, can one option be to consider the tokenised financial instrument as different from the original underlying financial instrument, similar to the “depositary receipts” model, in accordance with Article 3(1), point (b), of the DLT Pilot Regulation?

ESMA Answer

02-06-2023

Original language

[ESMA70-460-189 - Heading 7 - Question 3]

Answer provided by the European Commission in accordance with Article 16b(5) of the ESMA Regulation.

Partial tokenisation should be understood as part of the total issuance of a given financial instrument being issued as a DLT financial instrument, i.e. using distributed ledger technology, with the other part of the issuance of that instrument existing as a traditional financial instrument, without reliance on DLT. The DLTPR does not explicitly prohibit partial tokenisation of an issuance. Moreover, when laying down the conditions for allowing derogations from Regulation (EU) No 909/2014 (CSDR) in its Article 5(2), the DLTPR acknowledges in point (b)(ii) of that Article the possibility for only a part of an issuance to be recorded on a distributed ledger. Where the tokenisation pertains to only a part of an existing issuance that is already registered with a CSD, the operator of the DLT SS or the DLT TSS is to ensure the integrity of the issue in accordance with Article 37 CSDR or Article 5(2), point (b), DLTPR, whichever is applicable.

The DLTPR does not explicitly address the question on whether any entity other than the issuer can tokenise part of an issuance. However, as noted, the DLTPR does not exclude tokenisation of existing financial instruments by DLT market infrastructures. Nevertheless, any such tokenisation should occur whilst fully respecting any contractual obligations between the CSD where the financial instruments are registered prior to tokenisation and the issuer, the CSD and the participants of the securities settlement system operated by it, as well as applicable Union and national law.

The notion of fungibility is not defined in the DLTPR, nor is defined in the legislative acts that underlie it – CSDR and Directive 2014/65/EU (MIFID). In its usual meaning of the word, fungibility means that the two assets are interchangeable and of equivalent value. In case financial instruments with the same economic and legal features are partially registered with a traditional CSD and partially with a DLT SS or a DLT TSS, they should be considered fungible in the economic and legal sense. However, from an operational perspective, it might be the case that that the register of a traditional CSD and that of a DLT financial infrastructure are not technically linked in such a way that they ensure seamless interchangeability.

Regarding the question whether a tokenised bond can be regarded as different from the original underlying financial instrument, the DLTPR does not specify what is the relationship between the ‘underlying’ financial instrument, i.e. the instrument that was issued, recorded, transferred and stored outside a distributed ledger, using traditional financial infrastructure, and the DLT financial instrument that came into existence through tokenisation. However, DLT market infrastructures participating in the pilot are to ensure that any DLT financial instrument onboarded on their systems belong to one of the categories of instruments referred to in Article 3 DLTPR to be eligible for the pilot, and that the creation of such instruments is done in accordance with applicable law. Furthermore, irrespective of the arrangement in place, the issuer CSD for the underlying bonds and the operator of the DLT SS or the DLT TSS are to be always able to ensure the integrity of the issue in accordance with Article 37 CSDR or Article 5(2), point (b), DLTPR, whichever is applicable.

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