Draft Regulatory Technical Standards to further specify the liquidity requirements of the reserve of assets under Article 36(4) of Regulation (EU) 2023/1114

Question 1. Do respondents have any comment about the calibration of the percentages of reserve assets with specific maximum maturities as suggested in Article 1 and Article 2 of the draft RTS?

We do not understand the reasoning behind the requirements of 20% within one working day and 40% within five working days (30% and 60% for significant issuers respectively) In our opinion, these numbers are set to be very high, especially in comparison to the liquidity requirements of credit institutions which from our understanding determine their liquidity needs based on a 30-day period rather than a one- or five-day period. As however the liquidity requirements for credit institutions should be stricter than for issuers, in our opinion is seems be more reasonable to set the minimum requirements to lower amounts (this also applies to the requirements of significant issuers). It would be highly appreciated if you could provide more details on the reasoning how the values are determined.

In addition, as asset-referenced or e-money token are tradable continuously, even on weekends and outside of trading hours, we would appreciate if you could confirm that the definition of "working day" also applies for asset-referenced and e-money tokens in the same way as it does for other types of financial business activities. For instance, if a Saturday is evaluated, assets need to be available until Tuesday. This aspect is particularly important, as there are only a very few credit institutions who offer 24/7 services and in addition, they are offering these only for money transfers within its own organization but not for transfers to other credit institutions.

Question 2. Do respondents consider that the requirements in Article 1 and Article 2 related to the 1 and 5 working days maximum maturity could create excessive pressure in the repo market, taking into account the minimum required amount of deposits in credit institutions in the case of tokens referenced to official currencies?

We have concerns of excessive pressure potentially arising in the repo market due to large amounts of token redemptions within a short time period. As there are the requirements of holding at least 30% of reserves in cash (60% if the issuer is significant), there might be a large amount of repos to be unwind in a very short time period in order to replenish the minimum amounts of cash in order to be compliant with the minimum requirements. This unwinding might create excessive pressure on the market leading to market distortions.

Question 3. Do respondents have any comment on the proposed approach in Article 3 of the draft RTS to not increase the minimum amount of deposits from 30% (or 60% if the token is significant) of the asset referenced in each official currency?

Similar to the amounts of cash to be available within one and five working days in accordance with Article 1, we do not see the requirement of holding minimum amounts of 30% and 60% in cash reserves (please also see our answers to question one) and see lower amount to be sufficient. Although in our opinion, holding at least 30% of reserves in cash at credit institutions is still feasible per se, however, taking into account the provisions of concentration limits regarding credit institutions, it is operationally not feasible. In this regards, we are referring to our answer to question 5.

Furthermore, regarding the minimum limit of 60% for significant issuers, the feasibility is also impeded by the provisions of Article 5. In addition, the high amount of cash reserves will put the issuer in a position where he need to fulfil the following points all at the same time:

a) complying with the regulatory concentration limits,
b) complying with the over-collateralization requirement which becomes more complicated due to lower investment return from cash holdings compared to securities, 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).

In addition, the Article does not take into account the scenario of a negative interest rate environment which will greatly exacerbate the aforementioned concerns and most likely create impossible economical business conditions for e-money issuers. In addition, the requirement will most likely directly influence the results of stress tests based on interest rate risks, as the higher the cash reserves the larger the impact due to lower interest income.

We once more want to highlight that in our opinion there is the necessity of 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 do not have the possibilities credit institutions have, such as their access to capital markets or central banks and it will most likely be hardly feasible for them to build compliant structures which allow them to operate economically at the same time.

Question 4. Do respondents have any comment with the definition of the requirement of a minimum liquidity soundness and creditworthiness in the deposits with credit institutions as proposed in Article 4 of the draft RTS?

In our opinion, the definition of minimum creditworthiness and liquidity soundness is vague. There should be a clear guideline of what the authorities consider creditworthy and liquidity sound. In our opinion, these should be based on official credit ratings of recognized credit rating agencies, and in the absence of official credit ratings, based on financial figures such as profits, own funds, total assets compared to liabilities, etc.

Question 5. Do respondents have any comment about the definition of the requirement of a maximum concentration limit of deposits with credit institutions by counterparty in Article 5 of these draft RTS? And about the definition of the general limit considering, in addition to deposit with a bank, also the covered bonds issued by and unmargined OTC derivatives with the same bank counterparty?

Answer: In our opinion, the provisions of Article 5 are particularly for issuers not being credit institutions operationally not feasible and significantly impact not only the business model of issuers but also the whole operational setup. The current provisions involve structures which will create a lot of complexity and costs, and especially the required number of credit institutions is currently not feasible to be reached, and need to be adjusted due to the following reasons:

a) The maximum limit of cash held in account holding banks of 30% and 60% for significant issuer requires the issuer to have at least four different credit institutions in order to comply with Article 5.1; for significant issuer, the number increases to seven different credit institutions. In addition, the number of credit institutions increases,
    i. if a credit institution does not qualify as large institution and consequently only 5% can be hold at the credit institutions;
    ii. the issuer
        (1) needs to hold higher amounts in cash than the minimum requirements (e.g. during the time until investments are conducted in the beginning or in case of large e-money token purchases); or
        (2) want to hold higher amounts in cash due to liquidity and investment purposes (e. g. in order to erase market risks or concentration risk);
    iii. the limit of 2.5% of total assets of a credit institution is reached as the total issuance volume of e-money token increases over a certain level;
    iv. Article 4 puts further requirements in regards to the characteristics of potential credit institutions;
    v. other highly liquid assets or money market funds should be held from the same credit institution. Apart of the increase in the potential number of credit institutions, this also limits the possible investment universe;
    vi. only a very few number of market participants offer solutions that address redemptions or other liquidity needs outside the regular business hours of the existing payment system
b) There are only a very few crypto friendly credit institutions in the market which are willing to provide accounts for issuers. These credit institutions do however mostly not fulfil the requirements to qualify as large institutions or 2.5% of total assets of their balance sheet will be reached with low issuance volumes.
c) The requirement of a concentration limit has a negative impact on the operations of issuers as:
    i. Issuers are put in a competitive disadvantage compared to regular e-money institutions as the requirements in regard to concentration do not apply to regular e-money institutions;
    ii. High costs are created during the onboarding of the different credit institutions as well as during the ongoing operations;
    iii. Operational risk increases due to rebalancing requirements;
    iv. Default risk increase due to the necessity of using less creditworthy credit institutions as the number of potential participants in the market is highly limited;
    v. Most of the market participants are technologically not yet prepared to create appropriate business models with economic feasibility due to automatization (e. g. API integrations)

d) Total counterparty risk of credit institutions might be increased due to the necessity of using less creditworthy credit institutions as the number of potential participants in the market is highly limited. If concentration limits are not set as given, higher amounts of cash reserves could be held by more creditworthy and liquid credit institutions limiting the risk for the issuer and the e-money token holder outweighing the counterparty risks created by the concentration limits. In our opinion, the limits in regards to credit institutions should be set based on their credit worthiness, rather than at fixed numbers (taking into account a transition period if ratings change and the limits are fully used).
e) From our understanding the current provisions do not allow for the option to use credit lines against a pledge of level 1 highly liquid assets which would not only reduces liquidity risks but would also increase return opportunities for the reserve funds facilitating overcollateralization requirements.
f) The concentration limits do not take into account reserves without default risk such as the following for which concentration limits do not make sense and are only increasing risks and operational complexity and limiting economical feasibility:
    i. Cash hold with central banks
    ii. Liquid assets hold in an insolvency protected structure erasing counterparty risk; for instance, a fiduciary structure involving escrow accounts at central banks of member states. These accounts are on the one hand also highly liquid and on the other hand are not exposed to market risks or credit risks. In our opinion, there would be two different versions possible:
        (1) The central bank offers the accounts and is the fiduciary at the same time, or
        (2) The central bank offers the accounts and the fiduciary is a regulated credit institution

In addition, in our opinion, there should not be harder requirements for e-money issuers than for credit institutions or existing e-money institutions. In the current draft, the requirements both of them.

We once more want to highlight that in our opinion there is the necessity of a distinction between issuers being credit institutions and issuer not being credit institutions. In contrast to issuers being credit institutions, for issuer not being credit institutions the current requirements are hardly feasible from operational as well as economical side.

<u>Question 6. Do respondents have any concern about compliance with these concentration limits in Article 5, considering in particular paragraph 14 of the cost/benefit analysis in relation to the potential operational burden and risk of a wrong direction diversification, linked to the minimum required liquidity soundness and creditworthiness of deposits with banks, and taking into account the minimum amount required of deposits with credit institutions by MiCAR for tokens referenced to official currencies?</u>

Please see our answers to question 5. In general, in our opinion the analysis of advantages and disadvantages is not appropriately balanced enough and does not take into account factors being mentioned in our answers to question 5 which need to be considered for feasibility of the operational and economical business.

Question 7. Do respondents have any comment about the definition of the mandatory over-collateralisation in Article 6 of these draft RTS and the rationale for it? Do respondents find it challenging from an operational perspective, in particular with respect to envisaging 5 days windows rather than 1 day windows for observation periods of the market value of the assets referenced versus the reserve of assets and over the previous 5 years? Please elaborate your response with detailed reasoning.

From our understanding the current version of mandatory over-collateralization is a requirement which does not apply in such a way to regular e-money institutions. We therefore have concerns that the provision will put e-money issuers into a competitive disadvantage against regular e-money institutions if applicable regulations for e-money institutions will not be adjusted.

In addition, we have comments regarding the current form of the formula. Our answer here focuses particularly on e-money token. We assume, that "*Assets_Referenced"* at any time equals the number of outstanding e-money token. "*Reserve_Assets"* do face market price risk, if a fraction of "*Reserve_Assets"* is not held in cash deposits but in HQLA.

The definition of collateralization first of all states, that an under collateralization is not allowed at any given point in time. The general rationale to protect investors funds is appropriate. It is questionable if the additional own funds requirements are then required and adequate.

The over collateralization requirements in this definition are not feasible. The main problem is, that the maximum of "*Assets_Referenced"* and the minimum of "*Reserve_Assets"* might be derived from different days out of the last five consecutive days. Especially in the case of e-money token, "*Assets_Referenced"* and "*Reserve_Assets"* are very likely to change stronger due to inflows and outflows in the e-money token than to market price fluctuation. Even if all e-money token would be fully collateralized in any given point in time, fluctuations in the number of e-money token can lead to incredibly high over collateralization requirements.

From our understanding of the formula, we do see a risk of compliance with the requirements due to the five days windows. During periods of high e-money token purchases the maximal amount within 5 consecutive days will largely be higher than the minimum amount of the five consecutive days. For instance, after the start of operations the circulating amount of e-money token is likely to increase significantly so that it will be hard to comply with the requirements. The longer the consecutive time period, the harder it is to comply with the requirements. For clarification purposes, please see the following two examples:

	Example 1: Start of operations	Example 2: Phase with high redemption amounts
Day	**E-Money token in circulation**	**E-Money token in circulation**
1	1,000,000	1,000,000
2	1,200,000	960,000
3	1,400,000	940,000
4	1,600,000	920,000
5	1,800,000	890,000
Assets referenced at day t=6 *(assumed to be equal to day 5)*	**1,800,000**	**890,000**
Maximum Assets Referenced	1,800,000	1,000,000
Minimum Reserve Assets within the period *(Assumption for simplification: Reserves are 100% Cash Deposits without market price risk)*	1,000,000	890,000
(Max-Min)/Max	**44.44%**	**11.00%**
Minimum Reserve Assets	**2,600,000**	**987,900**

As one can see from the examples given above, the overcollateralization requirements can get very high based on just five consecutive days within a period of five years. Especially right after issuance of the token (as illustrated in example 1), high volatility must be considered increasing the requirements to amounts which can not be achieved given the investment and diversification restrictions. It therefore might be wise to exclude a certain timeframe for the initial token issuance. However, also during normal business activities (as illustrated in example 2) significant volatility might take place creating high minimum limits for a period of five years being hard to be achieved taking into account the investment restrictions. In our opinion, every day for the longer period of the consecutive days:

a) Increases the risk that reserve assets can not be achieved;
b) Increases the risk of a necessity of an ad hoc requirement to further increase the existing reserves as volatility and the gap between lowest and highest amounts grow;
c) Increases the willingness to use reserve assets for more risky asset classes due to forced compliance to the formula.

For instance, if only one consecutive day would be evaluated, the amount of reserve asset over the assets referenced would not need to be 11% but only 4% in example 2.

In our opinion, it is more reasonable to have a rule which requires the amount of reserve assets to be at least the amount of assets referenced potentially taking into account a minimal increase in order to consider potential value deterioration from costs for portfolio setup of reserve assets (e. g. trading fees). However, the increase should depend on the issuer's years of operations and need to be even achievable with returns of investments which do bear the lowest risk (i.e. interest income from cash holdings) in order to reduce the risk of a potential necessity to increase the reserve assets portfolio risk.

Question 8. Do respondent think that any provision in the draft RTS is confusing and that some clarification would be necessary?

A numerical example regarding the formula of Article 6 would be useful in order to ensure the right understanding of over-collateralization amounts of all market participants.