FESE position paper on tokenisation: Responsible adoption as a strategic opportunity

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Tokenisation is reshaping financial markets by opening new opportunities for innovation, efficiency and accessibility. It enables the digital representation of asset ownership, financial or other underlyings, on programmable ledgers, offering the same rights and obligations as traditional instruments while enhancing operational efficiency and security.[1] Benefits include improved transparency, and broader retail participation through fractional ownership. The programmability of the ledgers through so-called smart contracts could be used to combine tokenised assets with certain rules that govern processing, ownership transfer, and interaction with external conditions outside of the network.

Regulated markets could serve as the trustworthy and neutral administrators of smart contracts, capitalising on the high potential for process automation with tokenised assets within the DLT environment, while seamlessly integrating into the traditional financial system and fostering greater transparency and investor confidence in digital transactions.

The recent developments in the US, notably the finalisation of the Genius Act regulating payment stablecoins, and the ongoing Clarity Act, demonstrate a clear intent to clarify the regulatory framework for digital assets and actively harness their potential.

As the EU continues to shape its digital finance strategy with the implementation of Markets in Crypto-assets Regulation (MiCA) and the recent publication of the review of the DLT Pilot Regime, tokenisation could be seen as a powerful enabler of the goals outlined in the *Draghi Report on EU Competitiveness* by fostering innovation.

Building on the Savings and Investment Union objectives of modernising European frameworks and expanding retail access to financial markets, tokenisation of classical financial securities could further unlock capital to support the EU's strategic priorities. At the same time, it is important that the EU designs its regulatory framework in a way that avoids further liquidity fragmentation and ensures a level playing field between regulated and unregulated entities.

This paper outlines FESE's views on the opportunities, risks, and regulatory considerations for tokenisation in the EU context.

1. Regulated markets as gateways to trusted tokenisation

FESE believes that regulated markets (RMs), multilateral trading facilities (MTFs) and other lit trading venues are central to scaling tokenisation in a safe and transparent manner —

[1] World Economic Forum report on tokenisation (here), p. 7.

favouring evolution over revolution by both integrating new solutions into existing financial systems as well as using new set-ups under exploratory regimes for the benefit of clients.

The World Federation of Exchanges (WFE) has recently flagged investor protection concerns around pseudo-equity tokens lacking shareholder rights which underscores the need for careful and strategic adoption.[2] Unregulated crypto platforms often tend to mimic tokenised securities without providing the same rights and benefits of traditional financial instruments. In contrast, regulated markets, particularly those represented by FESE members,[3] support the tokenisation prospects and offer tokenised securities with appropriate investor protections, transparency, and rights equivalent to those of traditional securities.

With the growing retail investors' interest in crypto assets, mimicking tokenised securities may undermine their confidence in capital markets. Therefore, access to regulated markets and the level playing field between regulated and unregulated entities is essential. To build trust and mitigate risks (e.g. insider trading, integrity of the issuance, safekeeping of assets) and to support the uptake in tokenisation while maintaining technology-neutrality, tokenised securities should be issued by the same regulated entities as "traditional" securities (e.g., CSDs) as well as licensed new entrants, who would need to comply with the same regulatory requirements as traditional financial market infrastructure. It would ensure robust compliance with KYC and AML/CFT requirements and maintain full transparency of beneficial ownership. We see the following benefits of tokenised securities channelled via lit markets:

- **Appropriate consumer protection:** Standard MiFIR lit trading platforms such as RMs or MTFs will ensure that settlement and record keeping occur exclusively at NCA-licensed financial institutions. This will ensure, on the one hand, a high level of consumer protection when proving ownership and, on the other hand, the enforceability of third-party rights against the owner.
- **AML/CFT and KYC compliance:** Trading, settlement, and record keeping of tokenised investment instruments at MIFIR/EMIR/CSDR licensed financial institutions is also the most effective prevention against money laundering. At a minimum, a basic verification of the final beneficiary is carried out, and without proper identification, they are not allowed to acquire, hold, or dispose of tokenised investment instruments.
- **Cybersecurity and operational resilience:** The above-mentioned financial institutions fulfill a whole range of obligations under the Digital Operational Resilience Act (DORA) to ensure cybersecurity in an increasing digital world. Digital operational resilience is essential for ensuring the functionality of systemic IT solutions used in the trading, settlement and recording of tokenised investment instruments. Coupling these frameworks with the intrinsic resilience and security of DLT systems would allow to create a new infrastructure able to cope with the current and future IT challenges.
- **Prevention of liquidity fragmentation:** Tokenised securities traded outside established and regulated venues may further fragment the liquidity of lit markets by diverting order flows from exchanges and other regulated venues. Since certain equity tokens are essentially derivatives or depositary receipts backed 1:1 by stocks and custodied by a licensed brokerage, it remains unclear whether, in the event of failure of the broker, the token would still have value and who would own the underlying asset.

[2] "The World Federation of Exchanges urges crackdown on tokens that mimic equities", report (here)

[3] As seen in the recent Nasdaq proposal to the SEC on tokenised securities (here and here).

2. Appropriate taxonomy of cryptoassets

Since the classification of crypto assets remains fragmented across Member States, evolving hybrid products call for a more coordinated taxonomy of crypto assets, including with other major jurisdictions such as the US. The EU taxonomy of crypto assets should continue building on the achievements of the MiCA Regulation and provide further classification of the various types of crypto-assets to ensure legal certainty and uniform application of rules across national jurisdictions. A clear delineation between "financial instruments" issued in tokenised form and the crypto-assets that do not provide the same rights as traditional instruments must remain the central guiding principle of the classification.

Most digital assets are not tokenised securities

When categorising crypto-assets, it is crucial to underline that not all digital assets qualify as tokenised securities. While some digital assets represent ownership or entitlement to financial returns, other have more functional roles, such as granting access to a platform. For instance, tokenised equities give holders voting rights and dividends, just like regular equities, but the ownership is tracked on a blockchain instead of a central registry. Similarly, tokenised bonds hold the same obligation to repay interest and principal, maintaining the core features of conventional bond instruments. For instance, the SIX Digital Exchange (SDX) in Switzerland has issued tokenised bonds that are fully compliant with Swiss law and settle using digital Swiss francs.[4]

In principle, these assets should offer the same benefits and rights as their traditional counterparts, while offering greater efficiency and security potential thanks to the underlying DLT infrastructure. Digital assets that, instead, mimic these features may mislead investors, creating a wrong impression that they are investing into tokenised securities. Regulatory clarity, along with targeted awareness-raising initiatives, is essential for crypto asset categorisation. For instance, the recent ESAs statement on the risks of certain crypto-assets represents a positive step in this direction.[5]

The MiCA framework divides crypto-assets into the three main categories:

- Asset-referenced tokens (ARTs): Tokens that aim to maintain stable value by referencing a basket of assets (e.g., fiat currencies, commodities, or other crypto-assets).
- Electronic money tokens (EMT): Tokens pegged 1:1 to a single official currency (e.g., euro or dollar), used primarily for payments.
- Crypto-assets that are not considered ARTs or EMTs: This category covers tokens such as utility tokens.

Beyond these categories, there are many other types of digital assets such as Non-Fungible Tokens (NFTs), central bank digital currencies (CBDCs), decentralised finance (De-Fi) protocols, algorithmic stablecoins, among others. The proliferation of various types of crypto-asset which are not explicitly covered by MiCA and may fall in grey areas may lead to regulatory ambiguity and lead to difficulties in identification. It is crucial to identify ways for clear categorisation to ensure there is legal certainty and clear distinction between tokenised securities, digital assets and instruments that simply mimic their features. If

[4] SIX Digital Exchange, "Digital Bonds – Trusted and Regulated Gateway to Tokenized Securities" (here).

[5] "EU Supervisory Authorities warn consumers of risks and limited protection for certain crypto-assets and providers" (here).

pseudo-tokenised securities are permitted to trade, they should be clearly classified and either traded separately from traditional securities and true tokenised instruments, or traded against each other, to avoid investor confusion.

Technology-neutral and asset-function-first approach

FESE supports the current approach and specifications in MiFID II and MiCA that the technological format of crypto-assets, such as tokenisation, should not be considered a determining factor in classification. As specified in MiFID II Article 4(15), "*'financial instrument' means those instruments specified in Section C of Annex I, including such instruments issued by means of distributed ledger technology*". MiCA Article 2(4)(a) explicitly excludes "financial instruments" from its scope, meaning that if a crypto-asset falls within the definition of a financial instrument in MiFID II, then these crypto-assets should be treated as the defined instrument in MiFID II. We also welcome ESMA's specifications in its Guidelines on the classification of crypto-assets, which support a technology-neutral approach and underline that when a hybrid token displays features of a financial instrument, this characteristic should take precedence in its classification.[6]

FESE believes that it is important to promote a convergent approach among Member States in their classification, as assessments are currently conducted on a case-by-case basis by their local NCAs. Divergent outcomes, such as one NCA classifying a crypto-asset as a financial instrument while another one does not, may lead to further fragmentation. Therefore, fostering national convergence and a common understanding of classification criteria across all EU Member States is essential.

International cooperation on common principles for categorisation

To further harmonise crypto-asset categorisation, it is crucial that various jurisdictions cooperate to promote a common understanding of the categorisation criteria. Aligning international principles, particularly between the US, UK and EU frameworks, is an essential step toward standardisation. International forums such as IOSCO, or bilateral initiatives like the recently established US-UK taskforce on crypto-assets, could serve as key platforms to foster convergence on categorisation approaches.[7]

3. Additional policy recommendations

Tokenised securities need to be effectively embedded within traditional regulatory frameworks for the EU to fully leverage the benefits of tokenisation. These regulatory frameworks need to adapt and acknowledge the unique features of blockchain-issued tokenised securities. A poorly adapted framework may lead to circumvention of the lit regulated markets and a shift of business toward the OTC space, which lacks investor protection and transparency. That said, the proposed changes to CSDR (i.e. including DLT concepts/MiCA instruments) in the Market Integration Package (MIP), which enhance technological neutrality and foster innovation, are positive steps in the right direction.

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[6] ESMA Guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments, Guideline 1 & 9 (here).

[7] "US and UK Crypto Coordination Could 'Kick-Start' British Sector" (here).

DLT Pilot Regime

The DLT Pilot Regime (DLTPR) is an essential first step in exploring the necessary adaptions for the traditional regulatory frameworks. It presents an important regulatory innovation, especially the possibility to allow trading and settlement using DLT within one entity via the TSS-license. We would like to emphasise that regulatory sandboxes, such as the DLT Pilot Regime, should be designed to foster innovation while safeguarding investor protection, serving the interests of investors, and upholding the integrity of financial markets. We support the Commission's efforts to promote innovation and increase the attractiveness and business viability of the DLT Pilot Regime. Following the publication of the review of the DLT Pilot Regime within the MIP, we would like to provide our preliminary observations:

- **Clear transitional pathways**: Beyond providing clarity on the duration of the DLTPR, one of the most critical elements is providing legal and economic certainty for participants, especially regarding the transition from the pilot regime. Once pilot regime entities reach the proposed aggregate thresholds in market size or volumes, they must transition into standard regulatory frameworks within a reasonable and predefined timeframes. This should be accompanied by a modernisation of those frameworks to ensure that entities can continue offering the same services (see below).
- **Responsible expansion of the regime**: The higher aggregate threshold and the removal of asset-specific thresholds in the DLTPR are, in principle, positive as they support innovation, though further analysis is required to assess potential impacts. It is important to ensure that the expanded scope of eligible assets and revised thresholds under the DLTPR are implemented in a way that supports business uptake without compromising market integrity and financial stability. We would like to underline that extending the scope and significantly raising thresholds without an appropriate transition into a modernised traditional regulatory framework could potentially increase fragmentation in the EU market, and shift volumes to DLTPR from entities under the full regulation of MiFID II/R, CSDR, EMIR, contrary to the core objectives of the MIP.
- **Integration of the new entities**: The integration of crypto-asset service providers (CASPs) into the DLTPR could create overlaps with the MiCA Regulation. Further clarification would be needed on the NCA licensing process, particularly in light of the proposal to establish centralised supervision of CASPs under the ESMA mandate. We also would like to note that the expanded scope of entities appears to omit central counterparties (CCPs), and we recommend their explicit integration into the regime.
- **Modernising existing frameworks**: We recommend integrating DLT trading and settlement systems (DLT TSS) within a modernised CSDR and MiFID II frameworks. Likewise, we welcome targeted changes to broader regulatory frameworks (e.g., CSDR, EMIR, SFD) to allow market infrastructures to use tokenised and MiCAR-compliant instruments (for settlement or collateral). These changes need to be coupled with the clear transitional pathways and the potential expansion of the regime to avoid splitting liquidity and penalising regulated entities when embracing innovation. Both pilot regime and the existing regimes should be synchronised in embracing new technologies and not complacent in creating an uneven playing field nor room for regulatory arbitrage. Holistic embrace of these technologies will enhance market efficiency and legal certainty, foster innovation, and support Europe's competitive edge in global financial markets.

On-chain fiat money

To fully unlock the DLT potential, it is essential that the cash leg of transactions also operates "on-chain". In contrast to the traditional financial system, where both commercial bank money and ECB-issued central bank money coexist, we anticipate a similar need for the coexistence of all forms of on-chain money within the DLT ecosystem, such as MiCA-compliant stablecoins (EMTs), tokenised bank deposits, and a wholesale digital euro. Hence, FESE welcomes the inclusion of EMTs in the DLTPR and CSDR, enabling the settlement of securities transaction payments in e-money tokens.

At the same time, the ECB trials have already demonstrated the feasibility of settling transactions in central bank money via DLT, underlining the strategic value of on-chain fiat money.[8] To further optimise DLT-based settlement, it is crucial to move beyond pilot phases and accelerate the deployment of, at least, a wholesale digital euro. This would enable atomic, programmable delivery-versus-payment with finality in central bank money – a goal supported by promising ECB initiatives such as Pontes and Appia, though timely implementation remains key.

We would like to note that atomicity does not mean instant execution, as it only refers to consistent end states and avoids any transactions being processed incompletely. Instant execution would most likely not be favored by market participants, as it would require pre-funding the trades alongside the loss of netting efficiencies.

We stand ready to integrate all forms of money on-chain, such as stablecoins, tokenised bank deposits, and wholesale digital euro, once available, across our digital value chains and payment legs.

Conclusion

Tokenisation presents a strategic opportunity for the EU to modernise its capital markets and advance its broader objectives. Regulated markets and MTFs are essential players in this journey, offering the infrastructure and expertise to effectively scale tokenisation. Market infrastructures, as neutral and trusted entities, are uniquely positioned to lead the advancement of tokenisation. By leveraging their role as regulated markets and their proven track record in operating secure and resilient systems, they can act as honest brokers of innovation, facilitating the development of trustworthy DLT-based platforms while balancing the diverse interests of market participants in a fair and transparent manner.

FESE advises policymakers to:

- establish a proper taxonomy of cryptoassets and clear delineation between tokenised securities and other digital assets along the scopes of MiFID/R and MiCAR.
- look into the existing regulatory aquis of the EU and identify any necessary adaptations to unlock a full potential of tokenisation in a strategic and responsible way.

[8] "ECB commits to distributed ledger technology settlement plans with dual-track strategy" (here).