

BAI Newsletter – October 2019

Editorial article from Frank Dornseifer, Managing Director, BAI e.V.,

Dear Ladies and Gentlemen, dear members,

Focus on crypto assets & digitalization – asset management is becoming digital!

"We are setting the course for the token economy" is the motto of the federal government's blockchain strategy, which was adopted by the Federal Cabinet on the 18th of September and with which one sees oneself as a pioneer in utilizing the opportunities of blockchain technology and mobilizing its potential for digital transformation.

Within the framework of the blockchain strategy, special attention is paid to the financial sector, as blockchain technology found its first practical application here with the crypto currency Bitcoin, which then resulted in a hype – driven in part by the media.

In the meantime, the FinTech and crypto hype has subsided – to a large extent and hopefully not only temporarily – and the discussion is devoted to factual topics. The BaFin's progressive, pragmatic and result-oriented approach to FinTechs, the use of DLT and KI and the regulation and classification of crypto assets was very helpful in this context. In other words, it can be done without a regulatory sandbox!

Of course, the fact that the technology debate is becoming more objective does not mean that the disruptive potential of FinTechs and DLT, AI & Co. is relativized. On the contrary: visions are becoming reality! The significance and impact of blockchain and DLT on the (real) economy and, of course, on the financial sector can be read very clearly in the report recently published by the EU Commission's Joint Research Center entitled "Blockchain now and tomorrow – assessing multidimensional impacts of Distributed Ledger Technologies". And it is precisely with a view to this broad impact that it is essential that BAI should deal intensively with these technological issues and at the same time provide regulatory support. In Germany there is – as yet – no explicit blockchain law, as is the case in Liechtenstein and Switzerland, but at least there is a blockchain strategy.

With the adoption of the blockchain strategy, the Federal Government now wants to open another chapter in the technology book for Germany. It not only opens German law to electronic securities and creates legal certainty for trading platforms and crypto custodians; the comprehensive list of measures also contains initial concrete legislative projects such as the regulation of the public offering of certain crypto tokens.

The BAI has accompanied the various technology and regulation topics around DLT, BigData, KI, ICOs, crypto-assets, etc. for quite some time now. Both in BAI-Insights and Webinars, as well as a main topic on the homepage and in the BAI-Newsletter, but of course also in the expert committee Fund and Market Regulation. This week we are discussing the framework for electronic securities, crypto-assets and their safekeeping, and especially the effects on the fund industry, where individual aspects of the blockchain strategy are on the agenda again at the end of October.

Meanwhile, it is already quite clear where and how the financial services industry as a whole, but also the fund and asset management industry in particular, will change. After various current use cases for blockchain and distributed ledger technology in the financial sector, the discussion is now focused on fund-specific topics such as the distribution of fund units on a blockchain. Artificial intelligence, machine learning etc. are also already being used in analysis, processing and reporting processes. And – last but not least – crypto assets (especially tokens) have meanwhile established themselves as a (niche) asset class.

The BAI has already commented on the key issues paper of the BMF and BMJ on electronic securities and the regulation of crypto tokens, and we will provide constructive assistance in these legislative procedures. We also welcome the Federal Government's new blockchain strategy and the associated objective of not only tapping the potential of blockchain technology and preventing abuse, but also explicitly strengthening the role of Germany as one of the leading digitization and FinTech locations. In this context, we consider it both sensible and helpful to adapt the existing legal situation to block-chain and comparable new technologies where necessary, and to create the necessary legal and application security in civil and supervisory law. In our opinion, it should be ensured that block-chain-based instruments or instruments based on comparable technologies are not treated fundamentally differently from comparable instruments in the "analogue" world. Keyword: Technology neutrality!

The BAI Fund and Market Regulation Committee is responsible for the detailed discussion on this subject, in which we not only discuss the need for adjustments in the legal and regulatory framework, but also the possible effects on the distribution, investment and administration process. In the coming months, we will, of course, also increasingly address this issue via the various BAI event formats. And of course we look forward to an intensive exchange with you!

AIFMD, Solvency and CRR Review gain momentum, Obligation to notify cross-border tax arrangements before adoption

Of course, the "analogue" classical regulatory work will not be neglected either. The European legislative bodies in particular are currently ensuring that this is the case. Following the latest meeting of the Expert Group of the European Securities Committee (EGESC), the likely focuses of the upcoming AIFMD review are now emerging. These range from national private placement regulations and third country passports to risk and liquidity management, remuneration, custodian passports and digitisation issues. Although there is agreement that the AIFM Directive should not be fundamentally amended, this process must nevertheless be carefully monitored and followed. Particularly since unexpected advances from individual member states must always be expected, such as a single rule book for the asset management industry, in which the UCITS and AIFM Directives are to be combined. There is also a need to ensure that the AIFM Directive is

not subject to any fundamental amendment. There have also been individual calls for harmonisation of the rules governing lending by investment funds. These examples make evident that the AIFMD amendment is a volatile process which requires our full attention and support, especially in the current discussions between the newly constituted EU Commission and the Member States. In the first or second quarter of next year, we expect the EU Commission's report on the AIFMD review with concrete proposals for amending the directive.

We have already made considerably more progress with the Solvency Review. This is because EIOPA recently presented the Draft Technical Advice with proposals for revising the Solvency Framework on 15 October at the request of the EU Commission. The sheer size of the draft – including annexes – with more than 1,000 pages shows that heavy lifting will face not only the insurance industry but also the fund industry in certain areas. Currently, our first task is to review the proposed changes, assess the effects on capital investments, risk management, reporting, etc. and develop derivations for lobbying work. The Technical Advice contains a total of 19 regulatory areas, of which the proposals and questions relating to the equity sub-module are of particular relevance to our members and insurers with regard to capital investments. On the one hand, the new investment category "Long-term Equities", which, as is well known, was only adopted by the EU Commission in the political conclusion of the amended implementing provision, is being evaluated by EIOPA and, at the same time, potential improvements are being sought. We had previously warned of the unsuitability for practice with regard to the ring-fencing requirements, so that we now very much welcome the renewed opportunity to comment and see room for improvement, especially since the Technical Advice also proposes the phasing-out of the duration-based equity module. In this context, we also see the possibility of providing EIOPA with better correlation data, as EIOPA refers primarily to liquid MSCI indices, for example, which are known to have little relevance for unlisted equities. In addition to the equity sub-module, we will of course also comment on possible changes to the spread module and support the introduction of a sub-category "long-term fixed income". In addition, we will again focus on the issue of risk reduction through derivatives, as the proposals and discussions in the Technical Advice do not go far enough here, e.g. with regard to the use of long-short strategies.

Here, too, our members are cordially invited to accompany the consultation process with us. This work takes place in the BAI Expert Committee on Investor Supervision Law and, of course, with the involvement of the BAI Investors' Advisory Board.

The same applies to the CRR review, i.e. the Basel III implementation, for which the EU Commission recently launched the consultation and which is particularly relevant for our members and investors in that an increase in the risk weighting for so-called speculative equities, which also include private equity investments, is being discussed. There is therefore an urgent need for action here too.

Another European initiative, but now being implemented at national level, is the obligation to notify cross-border arrangements, which will entail considerable bureaucratic effort for the financial sector. On 9 October 2019, the Federal Cabinet adopted the government draft of an "Act introducing a duty to notify cross-border tax arrangements", which is intended to transpose Directive (EU) 2018/822 into German law. This was preceded by a consultation procedure scheduled to last three working days, which makes it clear how

open the Federal Government is to a constructive exchange with the industry. By the way, the legislative process is to be completed by 31 December 2019, so that all market participants are recommended to thoroughly examine the effects of the law without delay.

The BAI only recently took part in a hearing of the Federal Central Tax Office on technical and procedural issues, and we will continue to accompany the topic with the Investment Taxation Committee and are also planning an information event on this topic at short notice.

Sustainable Finance Initiative / BaFin Leaflet / BAI Workshop on ESG on 26.9.

In line with our ESG workshop, BaFin has submitted a draft of a leaflet on dealing with sustainability risks for consultation. The institutions supervised by BaFin now have until 3 November to comment. At our workshop, we already had the opportunity to discuss the draft directly with BaFin and, following on from this discussion, we will – with the involvement of the specialist committees – comment on the fact sheet. We presented how complex and challenging not only the handling of sustainability risks, but also the ESG-compliant capital investment and the essay and implementation of an ESG strategy are at our ESG workshop. At the same time, we also pointed out possible solutions and special features for alternative investments. The response and feedback to the workshop were very positive and we will of course continue to provide members, investors and the industry with comprehensive and in-depth information on the subject, especially as the dialogue on the Taxonomy Regulation has just been launched in Brussels and further measures of the Sustainable Finance Initiative are now being implemented step by step.

In addition, the Network for Greening the Financial System (NGFS) has just recently published its report "A sustainable and responsible investment guide for central banks' portfolio management" (https://www.dnb.nl/binaries/ngfs-a-sustainable-and-responsible-investment-guide_tcm46-385984.pdf), which contains instructive information on many aspects of ESG (including strategies, monitoring, reporting, implementation).

Please also note that our next BAI newsletter will focus on ESG. We will provide you with comprehensive information on this topic there and complementarily on the BAI homepage.

About the articles in this Newsletter

The main topic of this newsletter "Crypto Assets & Digitisation" has already been introduced at the beginning. We are pleased to be able to present to you some of the aspects mentioned above, but also some very informative technical contributions on this main topic. In detail these are:

- "Are crypto currency markets fair?", by Dr. Bjoern Holste, Technology Institute Frankfurt, and Prof. Dr. Christoph Gallus, THM-Technische Hochschule Mittelhessen
- "Securities on the blockchain: Effects of a new asset class as part of fund structuring", by Dr. Martin Schulte and Dr. Nick Wittek, Jones Day

- “Digital Assets – a systematic overview”, by Claus Hilpold and Dr. Dr. Philipp Cottier, L1 Digital AG
- “Waterfall/Carry calculation – still in Excel?”, by Gregor Kreuzer, qashqade AG
- “The crypto custody business as a future financial service”, by Jens Kretzschmann, Lennart Lorenz and Dr. Niklas Ulrich, Schnittker Möllmann Partners

I wish you an informative and entertaining read