Proposal for a regulation of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology

Pilot regime for DLT market infrastructures

European Commission
Objectives

Why

• Development of secondary markets for ‘tokenised’ financial instruments

• Promote the uptake of DLT in the trading and post-trading area

• Enable market participants and EU regulators to gain experience on new opportunities and issues raised by DLT

• Breaking the cycle, while ensuring financial stability, investor protection and market integrity:

- Lack of market infrastructures using DLT
- Difficulty to identify regulatory obstacles in EU legislation
- EU legislation are not fully adapted to DLT
Objectives

How

• **By introducing a pilot regime for DLT market infrastructures.** Under this proposal, DLT market infrastructures can request exemptions from specific requirements embedded in EU legislation (MiFID II, CSDR)

• NCAs are in charge of granting these exemptions, while ESMA ensures supervisory convergence

• To ensure a level playing field across the EU, the exemptions that can be requested are limited and conditions are attached to them.

• This regime is optional.
Two types of DLT market infrastructures

DLT multilateral trading facility (DLT MTF)
• A MTF (as defined under MiFID II)
• Operated by a MiFID II market operator or an investment firm
• Only admits DLT transferable securities
• And may be permitted to ensure (i) recording, (ii) settlement and (iii) safekeeping of DLT transferable securities

DLT securities settlement system (DLT SSS)
• A SSS (as defined under CSDR)
• Operated by a CSD
• That settles transactions in DLT transferable securities
Limits on DLT transferable securities (Art. 3)

- DLT transferable securities (defined as ‘transferable securities, issued, transferred and stored using a DLT’) admitted/recorded by DLT market infrastructure shall not be liquid:
  - Shares of issuers with a market cap of less than EUR 200 million
  - Convertible/covered/corporate/other public bonds with an issuance size less than EUR 500 million
- No sovereign bonds admitted/recorded by DLT market infrastructures
- DLT MTF or DLT SSS (allowed to settle transactions themselves) shall not record DLT transferable securities with a value exceeding EUR 2.5 billion
DLT market infrastructures: exemptions (Art.4 and 5)

Exemptions for DLT MTF

• Article 3 of CSDR


Exemptions for DLT SSS

• Derogation from some definitions under CSDR (dematerialised forms, transfer orders, securities account, recording of securities)

• Rules on intermediation

• Rules on outsourcing

• Rules on cash settlement

• Rules on standard link/access
DLT market infrastructures: exemptions (Art. 4 and 5)

- DLT market infrastructures can only request exemptions if:
  - It complies with the conditions attached to each exemption;
  - It demonstrates that the application of the provision is incompatible with DLT use;
  - The exemption requested is not extended to other MTFs or SSSs operated by the operator of the DLT market infrastructure
- The NCA granting the exemption can always attach additional conditions
Requirements on DLT market infrastructures (Art.6)

DLT market infrastructures are subject to specific requirements to mitigate some risks associated with the use of DLT:

• Clear business plan or written documentation
• Rules on the functioning of their DLT
• Obligation of information towards clients
• IT/cyber arrangements (and possibility for NCAs to ask for an audit)
• Safekeeping arrangements, including in the form of cryptographic keys
• Exit strategy
The permission to operate a DLT market infrastructure is in addition to an authorisation as a CSD or as an investment firm (or regulated market).

NCAs are in charge of granting those permissions as well as the exemptions.

To ensure financial stability, consumer protection and market integrity and consistency of the exemptions/permissions granted by NCAs, ESMA shall issue non-binding opinions.

NCAs can refuse a permission to operate a DLT market infrastructure if there are significant risks to financial stability/investor protection or risk of circumvention of existing rules.
Permission of DLT market infrastructures (Art. 7 and 8)

• Permission is granted by a NCA for a period of up to 6 years

• Permission can be withdrawn if:
  • A flaw has been discovered in the service provided by the DLT market infrastructure;
  • The operator or the DLT market infrastructure has breached the conditions attached to the exemption(s);
  • The operator of the DLT market infrastructure has admitted to trading or recorded DLT transferable securities that do not meet the criteria or the thresholds of Article 3.

• Where the permission is withdrawn, DLT market infrastructures activate their exit strategies.
Cooperation between DLT market infrastructures, NCAs and ESMA (Art. 9)

- Obligation for DLT market infrastructures to cooperate with NCA and ESMA
- NCAs may require corrective measures to the business plan of a DLT market infrastructure to ensure financial stability/investor protection/market integrity, after consultation of ESMA
- Every 6 months, the DLT market infrastructure shall submit a report to its NCA and ESMA
- ESMA plays a coordination role with a view to building a common understanding of DLT
Report and review (Art. 10)

- ESMA shall produce an annual report on the experimentation.
- After 5 years from the entry into application, ESMA shall produce a report on the experimentation.
- On the basis of ESMA’s report, the Commission presents a report to the Council and Parliament on whether the pilot regime shall be:
  - Extended for another period;
  - Extended to other types of financial instruments;
  - Made permanent with or without amendment;
  - Terminated.
Impact Assessment

accompanying the pilot regime
A ‘Europe fit for the digital age’ is a top priority under the current Commission presidency.

Especially regarding crypto-assets a unified approach is needed to allow innovations to bring benefits to the EU, while mitigating the risks to consumers.

The impact assessment is mainly based on the responses to the public consultation on crypto-assets launched in December 2019 as well as the advice from EBA and ESMA.
### Problem definition

<table>
<thead>
<tr>
<th></th>
<th>Crypto covered by EU legislation</th>
<th>Crypto not covered by EU legislation</th>
<th>Global stablecoins</th>
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<tbody>
<tr>
<td><strong>Drivers towards a legislative initiative:</strong></td>
<td>Lack of certainty as to how existing EU rules might apply</td>
<td>Absence of rules and diverging national rules for crypto-assets not yet covered by existing rules</td>
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<tr>
<td><strong>Problems to be addressed:</strong></td>
<td>Regulatory obstacles to the use of DLT and potential gaps in existing legislation</td>
<td>Consumer/investor protection risks and risks of fraud</td>
<td>Financial stability and monetary policy concerns</td>
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<td>Market integrity risks</td>
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<td>Market fragmentation/ risks to level playing field</td>
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<td><strong>Consequences:</strong></td>
<td>Missed efficiency gains in the issuance/ trade/post-trade areas</td>
<td>Missed funding opportunities for start-ups and companies (through low level ICOs/ STOs)</td>
<td>Missed opportunities in terms of financial inclusion and cheap, fast efficient payments</td>
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## General and specific objectives

<table>
<thead>
<tr>
<th><strong>Legal certainty</strong> for all crypto-assets</th>
<th><strong>Supporting Innovation</strong> and <strong>fair competition</strong> by creating a conducive framework</th>
<th><strong>High levels of consumer and investor protection</strong> and <strong>market integrity</strong></th>
<th><strong>Addressing financial stability and monetary policy risks</strong> (especially from a wide use of crypto-assets and DLT)</th>
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<tbody>
<tr>
<td><strong>Removing regulatory hurdles</strong> (e.g. to issuance, trading and post-trading of security tokens)</td>
<td><strong>Increasing the sources of funding</strong> (through ICOs and STOs)</td>
<td><strong>Limiting risks of fraud, money laundering and illicit practices</strong> in the crypto-asset markets</td>
<td><strong>Supporting access to new investment opportunities, new types of payment instruments and fueling competition</strong></td>
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<tr>
<td>Type of crypto-asset</td>
<td>Policy options</td>
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<td>Crypto-assets that are currently unregulated at EU level</td>
<td>Option 1: Opt-in regime</td>
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<td>Option 2: Full harmonisation regime</td>
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<td>Option 2: Targeted amendments to sectoral legislation</td>
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<td>Option 3: Pilot/experimental regime on DLT market infrastructure</td>
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<td>Crypto-assets that qualify as financial instruments under</td>
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<td>MiFID II</td>
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<td>Option 1: Bespoke legislative measures on stablecoins/global stablecoins</td>
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<td>Option 2: Bringing stablecoins and global stablecoins under the Electronic</td>
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<td>Money Directive 2</td>
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<td>Option 3: Measures limiting the use of stablecoins and global stablecoins</td>
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<td>‘Stablecoins’ and global ‘stablecoins’</td>
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## Preferred policy options

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<td><strong>a mix of:</strong></td>
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## Assessment of policy options: ‘unregulated’ crypto-assets

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<th><strong>PRO</strong></th>
<th><strong>CON</strong></th>
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<tbody>
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<td><strong>Opt-in regime:</strong></td>
<td> Possibility to instil trust in the crypto-asset market</td>
<td> No reduction of market fragmentation</td>
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<td> Less legislative arbitrage</td>
<td> Might create a two-tier market</td>
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<td> Possibility to scale-up across borders</td>
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<td><strong>Full harmonisation:</strong></td>
<td> Legal clarity for users, issuers and service providers;</td>
<td> Imposing costs on issuers and providers</td>
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<td> Same level of protection and market integrity across the single</td>
<td> Risk of arbitrage regarding third countries</td>
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<td>market</td>
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<tr>
<td></td>
<td> Financial stability</td>
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<td></td>
<td> Little risk of regulatory arbitrage</td>
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## Assessment of policy options; crypto-assets qualifying as financial instruments

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</table>
| **Non-legislative measures, guidance on the applicability of existing rules** | ➢ Would clarify on the qualification as financial instruments under MiFID II  
➢ More flexibility  
➢ Preserving the high level of investor protection, market integrity and financial stability, | ➢ Could have limited effect |
| **Targeted amendments to existing rules** | ➢ High degree of legal clarity  
➢ Addressing specific operational resilience risks | ➢ Isolated amendments may have limited effect |
| **Pilot regime** | ➢ Possibility to test the use of DLT on a larger scale, facilitate more reliability and safety  
➢ Enable competition with third countries  
➢ Investor protection and financial stability  
➢ Possibility to establish real use cases | ➢ Might not be fully adequate |
### Assessment of policy options: ‘stablecoins’ and ‘global stablecoins’

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<th>PRO</th>
<th>CON</th>
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</table>
| **Bespoke legislative regime** | ➢ Clear legal basis  
➢ Adequate levels of investor protection across the EU  
➢ Comprehensive and holistic EU framework  
➢ Financial stability and consumer protection risks addressed | ➢ Regulatory and supervision costs |
| **Regulating ‘stablecoins’ under EMD 2** | ➢ Possible comparability to e-money under EMD2  
➢ Higher protection of users’ funds  
➢ Limiting risks of shadow banking | ➢ Obligation for issuers to be authorised in the EU  
➢ May not mitigate risks by wallet providers  
➢ Could limit the number of ‘stablecoins’ in the EU |
| **Measures to limit the use of ‘stablecoins’ in the EU** | ➢ Restriction of ‘stablecoins’ and related services | ➢ Possible issue with Union competences  
➢ Questionable effectiveness |
Thank you

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