



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

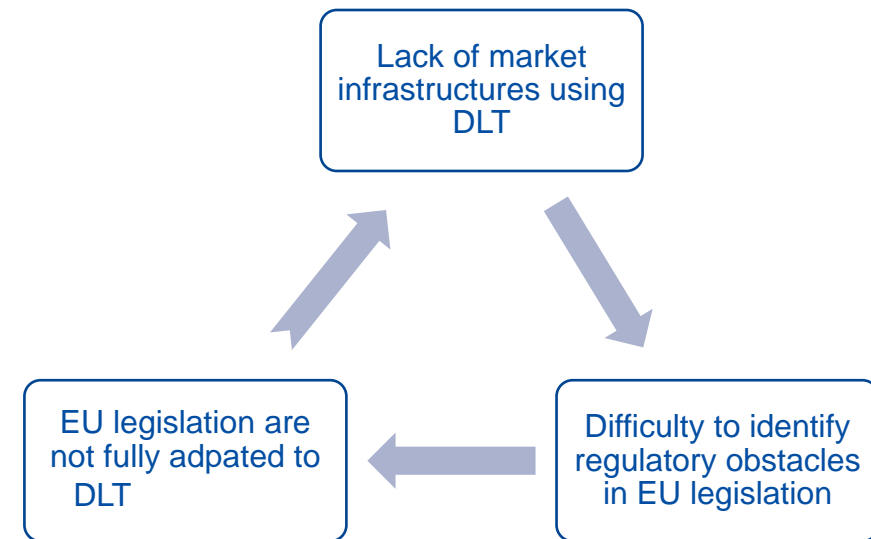
Pilot regime for DLT market infrastructures

*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:



# 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
- Obligation of intermediation of MTF (this derogation is in the Proposal for a Directive of the European Parliament and of the Council amending Directives 2006/43/EC, 2009/65/EC, 2009/138/EU, 2011/61/EU, EU/2013/36, 2014/65/EU, (EU) 2015/2366 and EU/2016/2341)

## 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



# Permission of DLT market infrastructures (Art. 7 and 8)

- 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

# Market and Legal context

- 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

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

# General and specific objectives

**Legal certainty** for all crypto-assets

**Supporting Innovation and fair competition** by creating a conducive framework

High levels of **consumer and investor protection** and **market integrity**

Addressing **financial stability and monetary policy risks** (especially from a wide use of crypto-assets and DLT)

**Removing regulatory hurdles** (e.g. to issuance, trading and post-trading of security tokens)

**Increasing the sources of funding** (through ICOs and STOs)

**Limiting risks of fraud, money laundering and illicit practices** in the crypto-asset markets

Supporting access to **new investment opportunities, new types of payment instruments** and **fueling competition**



# Overview: available policy options

Type of crypto-asset	Policy options
Crypto-assets that are currently unregulated at EU level	Option 1: Opt-in regime
	Option 2: Full harmonisation regime
Crypto-assets that qualify as financial instruments under MiFID II	Option 1: Non-legislative measures
	Option 2: Targeted amendments to sectoral legislation
	Option 3: Pilot/experimental regime on DLT market infrastructure
'Stablecoins' and global 'stablecoins'	Option 1: Bespoke legislative measures on stablecoins/global stablecoins
	Option 2: Bringing stablecoins and global stablecoins under the Electronic Money Directive 2
	Option 3: Measures limiting the use of stablecoins and global stablecoins

# Preferred policy options

Type of crypto-asset	Policy options
Crypto-assets that are currently unregulated at EU level	<del>Option 1: Opt-in regime</del> Option 2: Full harmonisation regime
Crypto-assets that qualify as financial instruments under MiFID II	<u>a mix of:</u> Option 1: Non-legislative measures Option 2: Targeted amendments to sectoral legislation Option 3: Pilot/experimental regime on DLT market infrastructure
'Stablecoins' and global 'stablecoins'	<u>a mix of:</u> Option 1: Bespoke legislative measures on stablecoins/global stablecoins Option 2: Bringing stablecoins and global stablecoins under the Electronic Money Directive 2 <del>Option 3: Measures limiting the use of stablecoins and global stablecoins</del>

# Assessment of policy options: 'unregulated' crypto-assets

	PRO	CON
Opt-in regime:	<ul style="list-style-type: none"><li>➤ Possibility to instil trust in the crypto-asset market</li><li>➤ Less legislative arbitrage</li><li>➤ Possibility to scale-up across borders</li></ul>	<ul style="list-style-type: none"><li>➤ No reduction of market fragmentation</li><li>➤ Might create a two-tier market</li></ul>
<b>Full harmonisation:</b>	<ul style="list-style-type: none"><li>➤ Legal clarity for users, issuers and service providers;</li><li>➤ Same level of protection and market integrity across the single market</li><li>➤ Financial stability</li><li>➤ Little risk of regulatory arbitrage</li></ul>	<ul style="list-style-type: none"><li>➤ Imposing costs on issuers and providers</li><li>➤ Risk of arbitrage regarding third countries</li></ul>

# Assessment of policy options; crypto-assets qualifying as financial instruments

	PRO	CON
<b>Non-legislative measures, guidance on the applicability of existing rules</b>	<ul style="list-style-type: none"><li>➤ Would clarify on the qualification as financial instruments under MiFID II</li><li>➤ More flexibility</li><li>➤ Preserving the high level of investor protection, market integrity and financial stability,</li></ul>	<ul style="list-style-type: none"><li>➤ Could have limited effect</li></ul>
<b>Targeted amendments to existing rules</b>	<ul style="list-style-type: none"><li>➤ High degree of legal clarity</li><li>➤ Addressing specific operational resilience risks</li></ul>	<ul style="list-style-type: none"><li>➤ Isolated amendments may have limited effect</li></ul>
<b>Pilot regime</b>	<ul style="list-style-type: none"><li>➤ Possibility to test the use of DLT on a larger scale, facilitate more reliability and safety</li><li>➤ Enable competition with third countries</li><li>➤ Investor protection and financial stability</li><li>➤ Possibility to establish real use cases</li></ul>	<ul style="list-style-type: none"><li>➤ Might not be fully adequate</li></ul>

# Assessment of policy options: ‘stablecoins’ and ‘global stablecoins’

	PRO	CON
<b>Bespoke legislative regime</b>	<ul style="list-style-type: none"><li>➤ Clear legal basis</li><li>➤ Adequate levels of investor protection across the EU</li><li>➤ Comprehensive and holistic EU framework</li><li>➤ Financial stability and consumer protection risks addressed</li></ul>	<ul style="list-style-type: none"><li>➤ Regulatory and supervision costs</li></ul>
<b>Regulating ‘stablecoins’ under EMD 2</b>	<ul style="list-style-type: none"><li>➤ Possible comparability to e-money under EMD2</li><li>➤ Higher protection of users’ funds</li><li>➤ Limiting risks of shadow banking</li></ul>	<ul style="list-style-type: none"><li>➤ Obligation for issuers to be authorised in the EU</li><li>➤ May not mitigate risks by wallet providers</li><li>➤ Could limit the number of ‘stablecoins’ in the EU</li></ul>
Measures to limit the use of ‘stablecoins’ in the EU	<ul style="list-style-type: none"><li>➤ Restriction of ‘stablecoins’ and related services</li></ul>	<ul style="list-style-type: none"><li>➤ Possible issue with Union competences</li><li>➤ Questionable effectiveness</li></ul>

# Thank you



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