

Regulation (EU) on a pilot regime for market infrastructures based on distributed ledger technology

On 2 June 2022, Regulation (EU) 2022/858 of the European Parliament and of the Council, of 30 May 2022, on a pilot regime for market infrastructures based on distributed ledger technology ("**DLT Pilot Regulation**") was published in the Official Journal of the European Union and will be generally applicable as of 23 March 2023.

The main objective of the DLT Pilot Regulation is to enable the **development of crypto-assets** that are considered **financial instruments**, commonly referred to as security tokens, as well as their issuance, trading and settlement through the use of **distributed ledger technology** ("DLT"). The fundamental axes of the DLT Pilot Regulation are the following:

- The **definition of "financial instrument"** in MiFID II is amended to clarify that those issued by means of DLT will also be considered as such, therefore now covered by the regulatory framework applicable to financial instruments.
- The introduction of a "**controlled testing environment**" **approach or sandbox**, that allows DLT-based market infrastructures to request temporary exemptions from some of the requirements of the applicable legislation in the matter of financial instruments that limit or impede the use of DLT, in exchange for the imposition of certain countermeasures.
- There are three market infrastructures that may benefit from this pilot regime: (i) **DLT multilateral trading facilities**; (ii) **DLT settlement systems**; and (iii) **DLT trading and settlement systems**, in all three cases as long as they are based on DLT and have received a specific authorization according to the DLT Pilot Regulation.
- ESMA will submit a report to the Commission on the functioning of the pilot regime, in view of which the Commission will propose to the European Parliament and the Council the **extension of the pilot regime** for a maximum of three years, its **extension** to other financial instruments, its **conversion** into a permanent regime or its **termination**.

The DLT Pilot Regulation is available [here](#).

1. SECURITY TOKENS: FINANCIAL INSTRUMENTS GOVERNED BY THE TRADITIONAL REGULATIONS APPLICABLE TO THIS MATTER

A crypto-asset has been defined by the few regulatory references published to date as a digital representation of value or rights that can be transferred and stored electronically, using DLT or similar technology. In September 2020, with respect to the development of the regulatory framework for crypto-assets, the European Commission published its digital finance strategy for the European Union (EU), distinguishing between two legislative strands:

- (i) On the one hand, a new EU legal framework that applies generally to crypto-asset markets, based on a taxonomy of definitions of their different types, will be established. This initiative has crystallised in the MiCA Regulation Proposal¹, still pending approval. MiCA will expressly exclude from its scope of application crypto-assets that are considered financial instruments under MiFID II², commonly known as security tokens.
- (ii) On the other hand, for those crypto-assets that are considered security tokens, the current EU rules on financial instruments will apply, for which purpose a pilot regime would be created for the development of the necessary market infrastructures. The approval of the DLT Pilot Regulation responds to this second legislative initiative.

In other words, when a crypto-asset presents certain characteristic notes, it must be considered a financial instrument and, therefore, it will be regulated by the regulations traditionally applicable to financial instruments. Thus, the DLT Pilot Regulation modifies something as elementary as the definition of financial instrument contained in MiFID II, to clarify that instruments that have been issued through DLT may also be considered as such.

In view of the above, security tokens will be under the scope of application of regulations such as the Market Abuse Regulation, the Regulation on prospectuses, public offerings and admissions to trading, the Regulation on settlement and central securities depositories or the Transparency Directive, among others, as well as of the transposition and development regulations in Spain.

2. THE PILOT REGIME: A TESTING ENVIRONMENT FOR DLT MARKET INFRASTRUCTURES

The traditional regulations governing financial instruments were not designed with the DLT and crypto-assets in mind, and therefore contain some provisions that could prevent or restrict the issuance, trading and settlement of security tokens. There are also certain legal loopholes due to the particularities of the DLT and security tokens themselves.

Thus, the DLT Pilot Regime introduces a sandbox, i.e. a controlled testing environment that temporarily exempts specific DLT-based market infrastructures from some of the requirements of the applicable regulations on financial services. This will allow, on the one hand, to test such DLT-based market

¹ Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, the final text of which has not yet been adopted.

² Directive 2014/65/EU of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

infrastructures and, on the other hand, to allow regulators to draw conclusions and gain experience on the specific opportunities and risks related to security tokens and their underlying technology.

In turn, countermeasures are introduced to ensure the proper functioning of such market infrastructures throughout the EU and to guarantee investor protection, market integrity, financial stability and transparency.

No later than 24 March 2026, ESMA³ must submit a report to the Commission on the operation of this pilot regime across the EU, including information regarding the number of authorised infrastructures, the value of security tokens admitted to trading, the types of technology used, main risks, etc. Within three months of receiving this report, the Commission must propose to the Parliament and Council either that the pilot regime be extended for a maximum of three years, that its scope be increased to include other financial instruments, that it be modified, that it be converted into a permanent regime with the appropriate amendments to the regulations in force, or that it be terminated, together with all the authorisations granted under the Regulation.

3. NEW MARKET INFRASTRUCTURES BASED ON DLT

The pilot regime introduces the concept of DLT market infrastructures, which are those that may benefit from this regime. These infrastructures are:

- (i) DLT multilateral trading facilities: multilateral trading facilities (“**MTFs**”) that only allow security tokens to be traded (“**DLT MTFs**”). They will be managed by a credit institution (“**CI**”) or market operator authorised under MiFID II;
- (ii) DLT settlement systems: settlement systems (“**SSs**”) that settle transactions with security tokens against payment or delivery, and allow the initial registration or the provision of custody services in relation to security tokens (“**DLT SSs**”). They will be managed by a central securities depository (“**CSD**”), authorised under Regulation (EU) No. 909/2014; and
- (iii) DLT trading and settlement systems: either DLT MTFs or DLT SSs that provide a combination of both infrastructures’ services (“**DLT TSSs**”). Depending on their nature, they will be managed either by a CI or market operator or a CSD.

Market infrastructures based on DLT will in principle be subject to the requirements generally applicable to them as an MTF or a CSD, as the case may be.

However, on the one hand, these infrastructures may request to the competent authority one or more temporary exemptions, provided that they are proportionate, justified by the use of the DLT and the requirements associated with such exemptions are met. In addition, the exemptions requested must be limited to the market infrastructure in question and not extend to any other MTF or SS managed by the applicant.

³ European Securities and Markets Authority.

On the other hand, the competent authority must establish additional appropriate compensatory measures in order to achieve the objectives of the provisions for which an exemption has been requested or to ensure investor protection, market integrity or financial stability.

The governing bodies of each DLT infrastructure are subject to a specific authorisation regime for their management. The authorisation to manage an infrastructure based on DLT, as well as the exemptions that may be approved, will be valid throughout the EU and be granted on a temporary basis for a maximum period of six years (i.e. within the duration of the pilot regime).

A summary of the main elements of the authorisation regime, requirements and exemptions for each market infrastructure based on DLT is included as an **annex**.

In addition to the countermeasures mentioned in such annex, the DLT Pilot Regulation establishes certain additional requirements with which DLT market infrastructures must comply, which are mainly and summarised as follows:

- (i) business plans must be prepared comprising their services and activities, their critical personnel, technical aspects, the use of DLT, how they carry out their services and activities and how the DLT market infrastructure differs from a non DLT-MTF or a non-DLT SS, as well as the standards under which the DLT in question operates and functions;
- (ii) IT and cybersecurity systems related to their DLT must be established to guarantee the continuity, reliability and security of their services and activities, as well as the integrity, security, confidentiality and accessibility of the data stored;
- (iii) when the governing body guarantees the custody of funds, guarantees, security tokens and their means of access (cryptographic keys), there shall be adequate means of protecting them, secure and reliable records of the funds shall be kept, and such assets shall be segregated from the participants using the infrastructure in question;
- (iv) in the event of the loss of the above assets, the governing body must be liable up to the market value of the lost asset;
- (v) they must establish a strategy for reducing the activity, transitioning out of, or ceasing to operate the infrastructure, including transitioning or reverting their DLT operations to traditional market infrastructures, which must be implemented in certain scenarios; and
- (vi) specific reporting obligations to the competent authority must be complied with, to enable the monitoring, evaluation and supervision of the market infrastructure based on DLT (including the obligation to submit a semi-annual report).

4. FINANCIAL INSTRUMENTS THAT CAN BE ADMITTED TO TRADING TO OR REGISTERED ON A DLT MARKET INFRASTRUCTURE

In order to preserve market integrity and the investor protection mechanisms, while avoiding risks to financial stability, during the period of the pilot regime, only the following may be admitted to trading or registered in DLT infrastructures:

- (i) shares of issuers with a market capitalisation of less than EUR 500 million;
- (ii) bonds, other forms of securitised debt, including depositary receipts in respect of such securities, or money market instruments, with an issue size of less than EUR 1 billion (excluding those that embed a derivative or structure that makes it difficult for the client to understand the risks involved); and
- (iii) specific stakes in collective investment undertakings the assets under management of which have a market value of less than EUR 500 million.

In addition, the DLT Pilot Regulation establishes a limit on the aggregate market value that each infrastructure may admit to trading or have registered, both at the initial time of admission or registration of a new security token (EUR 6 billion), and at any time thereafter, as a result of the increase in value of the security tokens in question (EUR 9 billion). If this second limit is exceeded, the DLT market infrastructure's strategy for transitioning to traditional market infrastructures must be applied.

The above thresholds may be reduced by the competent authorities.

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ANNEX

MANAGEMENT	AUTHORISATION PROCEDURE	EXEMPTION AND ASSOCIATED REQUIREMENTS
DLT MTFs		
Managed by a CI or market operator authorised under MiFID II, provided it has obtained a specific authorisation under the DLT Pilot Regulation	The procedures are broadly the same as those for authorisation under MiFID II for an MTF (in accordance with MiFID II and MiFIR ⁴), with the relevant amendments in relation to the exemptions that are requested under the DLT Pilot Regulation	Exemptions may be requested from: <ul style="list-style-type: none"> • the obligation to intermediate, therefore enabling natural and legal persons to deal on own account either as members or participants (subject to specific requirements) • the transaction-reporting requirements under MiFIR
DLT SSs		
Managed by a CSD authorised under Regulation (EU) No. 909/2014, and which has received a specific authorisation under the DLT Pilot Regulation	The procedures are broadly the same as those for authorisation under Regulation (EU) No. 909/2014 for a SS, with the relevant amendments in relation to the exemptions requested under the DLT Pilot Regulation	Exemption may be requested from: <ul style="list-style-type: none"> • the rules applicable to CSDs and which refer to the terms “dematerialised form”, “securities account” or “transfer orders”, provided that: (i) the use of a securities or book-entry account is incompatible with the use of DLT, (ii) the use of a decentralised register, the integrity of the issue and the ability to segregate financial instruments belonging to different participants, is ensured, and (iii) no overdrafts of securities are allowed • the obligation to establish procedures to prevent and deal with settlement, provided that the details of the operations can be clearly known and such faults can be avoided or corrected • the authorisation requirement to outsource basic services, provided that it is incompatible with the use of the DLT • the admission of natural and legal persons to deal on their own account as members or participants (subject to specific requirements) • the requirements for participants to access the SS, and on the communication procedures of the CSD with such participants and other market infrastructures, as well as specific transparency requirements provided that open, fair, transparent, objective and non-discriminatory criteria for participation are published and provided that prices and fees for settlement services are published

⁴ Regulation (EU) No. 600/2014 of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments and amending Regulation (EU) No. 648/2012.

		<ul style="list-style-type: none"> • the rules on settlement finality, provided that inter alia transactions settle close to real time or intraday and that settlement rules are published • the rules on cash settlement, provided that the CSD performs the settlement according to the delivery-versus-payment mechanism, being able to do so through central bank money, CSD accounts or commercial bank money in the same terms as provided for in Regulation (EU) No. 909/2014, but also in tokenised form, as well as using e-money tokens⁵ • the obligation for a CSD –when operating a DLT SS– to grant access to another CSD or market infrastructure, when the use of the DLT is incompatible with legacy systems, or when granting access to such systems would be disproportionate
DLT TSSs		
<p>Managed by a CI or a market operator authorised under MiFID II, or by a CSD, authorised under Regulation (EU) No. 909/2014, and which has received a specific authorisation under the DLT Pilot Regulation</p>	<ul style="list-style-type: none"> • The above provisions for authorisations to manage DLT MTFs or DLT SSs shall also apply <ul style="list-style-type: none"> • A CI or market operator operating a DLT TSS shall be subject to the requirements specific to an MTF (in accordance with MiFID II and MiFIR) and, <i>mutatis mutandis</i>, to those applicable to CSDs in accordance with Regulation (EU) No. 909/2014 (with the exception of, among others, the authorisation, organisational and prudential requirements, in accordance with such regulation) • A CSD operating a DLT TSS shall be subject to the requirements specific to a CSD (in accordance with Regulation (EU) No. 909/2014) and <i>mutatis mutandis</i>, to those applicable to an MTF in accordance with MiFID II and MiFIR (with the exception of specific authorisation and operating requirements in accordance with MiFID II) 	<p>Requirements in respect of which an exemption has been granted do not apply. Notwithstanding, DLT TSS governing bodies may apply for the same exemptions as those available to DLT MTF governing bodies and DLT SS governing bodies, under the same terms</p>

⁵ This crypto-asset will fall within the scope of MiCA, which, as defined in Art. 3.1(4) of MiCA, is "a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender."

CONTACT LAWYERS



Pablo González-Espejo García
Head Partner of the Digital Law Group
+34 91 587 08 34
pablo.gonzalezesejo@uria.com



Enrique Nieto
Partner, Capital Markets
+34 91 587 09 09
enrique.nieto@uria.com



Isabel Aguilar Alonso
Partner, Financial and Banking Regulation
+34 91 586 03 65
isabel.aguilar@uria.com



Álvaro López
Managing Associate, Capital Markets
+34 91 586 07 64
alvaro.lopez@uria.com
