EJTN civil justice seminar

SMART CONTRACT: A COMPARATIVE VIEW

"Digital Finance Package"

Outline

The European Commission "Digital Finance Strategy" sets out general lines on how Europe can support the digital transformation of finance in the coming years, while regulating its risks. The strategy sets out four main priorities: removing fragmentation in the Digital Single Market, adapting the EU regulatory framework to facilitate digital innovation, promoting a data-driven finance and addressing the challenges and risks with digital transformation, including enhancing the digital operational resilience of the financial system.

In pursuing its Digital Finance Strategy, on September 24, 2020, the European Commission adopted a "*Digital Finance Package*", including legislative proposals for a Pilot-Regime for DLT based Market Infrastructures, a Regulation on Markets in crypto-assets ("MiCA"), a Regulation for the Digital operational resilience ("DORA") and an "*omnibus*" directive amending sectorial legislation.

With a view to adapting the latest technological trends in the Fintech sector, the European Commission proposes a new digital financial legal framework driven by the overarching goal to provide legal certainty for all crypto-assets.

Crypto-assets are introduced as "*digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology".* The new framework is intended to enable firms to innovate within this space with full clarity about the applicable rules, in a way that aims at preserving financial stability, market integrity and protecting investors.

Crypto-assets differ, though, in terms of functionality and risk. In the European Commission's view, this justifies a differentiated regulatory treatment: crypto-assets that qualify as financial instruments (referred to also as *security-token*) pose the same risks of a financial instrument and should be regulated as such. Crypto-assets that have different functions do not pose the same risks: regulating them as financial instruments would be disproportionate and would hamper innovation.

Against this background, the amending directive intervenes on the definition of "financial instrument" in MIFID II to clarify beyond any legal doubt that such instruments can be issued on a distributed ledger. Financial instruments issued on a distributed ledger technology fall within the scope of the *Pilot Regime* proposal.

The ***Pilot regime*** **proposal** acknowledges that DLT and financial instruments in crypto-asset form are in an embryonic stage. This makes it difficult to identify all regulatory obstacles that would require immediate legislative action. Therefore, a sort of "sandbox scheme" is designed to enable regulated institutions (MTF's operators and CSDs) to develop DLT-based infrastructures for the trading, custody and settlement of securities by benefiting from temporary exemptions from certain regulatory requirements (stated by MiFID II and CSDR respectively). Access to the Pilot regime will put these infrastructures in a position to test the feasibility of their business models and regulators in a position to learn, by monitoring the use of DLT in market infrastructures. To ensure a level playing field across the EU, the exemptions that can be requested are limited and subject to conditions. Transferable securities that may be admitted to the Pilot regime are restricted as well as to their market cap/size and types. The supervised experimentation regime will be optional. The specific permission and the exemptions granted by NCAs, in consultation with ESMA, should be granted on a temporary basis, for a period of up to six years. Following the experimentation, on the basis of an ESMA's report, the Commission will present a report on whether the *Pilot regime* shall be: extended in time or scope; made permanent with or without amendments; terminated.

The **MiCAR** proposal is intended to catch those crypto-assets which do not qualify as financial instruments. The scope of the proposal includes therefore all crypto-assets not covered elsewhere in financial services legislation, entities issuing crypto-assets, as well as firms providing services in connection with crypto-assets (such as custodial wallets and crypto-asset trading platforms). MiCAR establishes minimum disclosure requirements on the issuance and admission to trading of crypto-assets: issuers intending to offer crypto-assets to the public within the EU or seeking the admission of such crypto-assets to a trading platform for crypto-assets have to be legal entities, shall draft a whitepaper, notify the whitepaper to their home competent authority and publish it (unless an exemption applies).

To ensure consumer protection, they also have to adhere to specific rules of conduct. *Crypto-asset service providers* will have to obtain a specific authorisation, will be subject to – *inter alia* – governance requirements, prudential requirements and safekeeping of client's assets requirements. MiCAR envisages a passporting regime, that will enable crypto-asset service providers who are authorised in one Member State to provide their services cross-border without any additional authorisation. To ensure market integrity, the proposal also contemplates bespoke measures to prevent market abuse. Stricter requirements apply in connection with crypto-assets seeking to retain a *stable value*, that may qualify under MICAR as "asset-referenced token" or "e-money token". *Significant* asset-referenced tokens or *significant* e-money tokens are subjected to enhanced rules and a dedicated supervisory framework.

The **DORA** proposal intends to make sure that all participants in the financial system have the necessary safeguards in place to mitigate cyber-attacks and other risks. All firms will be required to ensure that they can withstand any kind of ICT-related disruptions and threats. The proposal also aims at introducing an oversight framework for ICT providers.

The Digital Financial Package initiative is enough evidence that the regulation of financial market is trying to be fit for the digital era. Are national civil laws acting likewise?

Is a rediscovery of the role of private law in the regulation of financial markets a prerequisite to embrace successfully the upcoming transformation?