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Hot Topic

Deal struck on EU's DLT pilot regime

On 24 November 2021, the European Parliament announced an agreement with the Council on the Commission's proposal for a Regulation on a pilot regime for market infrastructures based on distributed ledger technology (the 'DLT pilot regime'). This provisional political agreement concludes the inter-institutional negotiations ('trilogue') that had started on 29 September 2021, almost exactly one year after the publication of the Commission's proposal. The brevity of the trilogue negotiations should not detract from the fact that the Council and the European Parliament had different ideas on a number of fundamental questions, in particular in relation to the scope of the DLT pilot regime. In the following, we will first provide a brief overview of the DLT pilot regime before taking a closer look at the main issues discussed during the trilogue negotiations and the compromise reached between the Council and the European Parliament as reflected in the provisional agreement.

1. Overview of the DLT pilot regime

The DLT pilot regime is a centrepiece of the European Commission's Digital Finance Strategy, a package of measures to further enable and support the potential of digital finance in terms of innovation and competition while mitigating the associated risks. Besides the DLT pilot regime, the Commission's Digital Finance Strategy also includes a draft Regulation on Markets in Crypto-assets and a draft Digital Operational Resilience Act. The DLT pilot regime aims to test the development of the European infrastructure for trading, clearing and settlement of 'tokenised' financial instruments. The experience gained with the pilot regime should help market participants as well as EU regulators to identify new opportunities and issues raised by distributed ledger technology ('DLT') while ensuring financial stability, investor protection and market integrity.

Under the DLT pilot regime, market infrastructures such as central securities depositories ('CSDs') or multilateral trading facilities ('MTFs') may apply for permission to provide trading or settlement services for financial instruments using DLT. The DLT pilot regime sets out the requirements for the operation of DLT market infrastructures, which are similar to those for the equivalent traditional market infrastructures. However, DLT market infrastructures may apply for exemptions from certain requirements embedded in EU legislation such as the Markets in Financial Instruments Directive ('MiFID') or the Central Securities Depositories Regulation ('CSDR').

For example, the operator of a DLT MTF may be granted the possibility to admit as members or participants not only financial intermediaries as required by Article 53(3) MiFID, but also natural and legal persons to deal on own account, where they fulfil certain eligibility requirements, relating to factors such as sufficient level of trading ability and experience, including knowledge of the trading and the functioning of DLT. This would, at least in theory, allow them to offer direct access to retail investors, as many distributed ledger networks seek to do.

Similarly, a CSD operating a DLT settlement system can request exemptions from a list of specified CSDR provisions, such as the rules on securities accounts and book-entry, if these are incompatible with the use of the particular DLT deployed.

The DLT pilot regime also imposes additional requirements on operators of DLT market infrastructures, in order to address the novel forms of risk raised by the use of DLT – for example, in relation to disclosures, IT and cyber security, and safeguarding of clients' funds.

2. Controversial Points and provisional agreement

While the Council and the European Parliament largely agreed on the details of the DLT pilot regime after their respective examination of the Commission's proposal, some fundamental issues were controversial. In their provisional agreement, the co-legislators reached consensus on the following main issues, which were discussed during the trilogue negotiations:

- the scope of the DLT pilot regime, in terms of the requirements for entities allowed to participate in the regime;
- the limitations on DLT financial instruments that can be admitted to trading on or recorded by DLT market infrastructures;
- the allocation of supervisory responsibilities between national competent authorities ('NCAs') and the European Securities Markets Authority ('ESMA'); and
- the liability of DLT market infrastructures for risks related to the functioning of the DLT they operate.

Definition of DLT market infrastructure

In the Commission's proposal, the term 'DLT market infrastructure' was intended to include DLT MTFs and DLT settlement systems. While DLT MTFs were to be given the possibility to perform CSD activities under the DLT pilot regime, DLT settlement systems did not have the same possibility to perform MTF activities. In addition, it was envisaged that DLT market infrastructures would follow different rules when performing the same activity, with less stringent requirements for DLT MTFs to perform CSD activities than for DLT securities settlement systems.

To avoid an unlevel playing field between the two types of DLT market infrastructures, the European Parliament suggested a symmetric approach, according to which (i) a DLT MTF performing settlement services must follow the same requirements as a DLT settlement system; (ii) a DLT settlement system must be allowed to perform the roles of a DLT MTF; and (iii) a third type of DLT market infrastructure for performing both trading and settlement services should be introduced.

The amendment proposed by the European Parliament was finally accepted by the Council. Accordingly, the term 'DLT market infrastructure' is now defined to mean a 'DLT MTF', a 'DLT settlement system' or a 'DLT trading and settlement system'. While DLT MTF means a multilateral trading facility, that only admits to trading DLT financial instruments and DLT settlement system is defined as a settlement system that settles transactions in DLT financial instruments, against payment or against delivery and allows at least the initial recording of DLT financial instruments or the provision of safekeeping services in relation to DLT financial instruments, DLT trading and settlement system means a DLT MTF or DLT settlement system that combines the services performed by both a DLT MTF and a DLT settlement system.

In addition, it is worth mentioning that the Commission's proposal originally allowed only authorised investment firms, market operators and CSDs to apply for a permission under the DLT pilot regime, thus limiting it to incumbent firms only. This approach was widely critizised in the market as running counter to the Digital Finance Strategy's explicit goal of supporting

innovative start-ups. Following a proposal of the Council, this approach was slightly modified. Accordingly, it is now also possible for unregulated entities to apply for a specific permission under the DLT pilot regime, if they simultaneously apply for authorisation as an investment firm under MiFID or as a CSD under CSDR, as applicable. This would at least theoretically allow start-ups to benefit from the DLT pilot regime, although it seems rather unlikely that start-ups have the necessary resources to meet the requirements for DLT MTFs or DLT settlement systems envisaged under the DLT pilot regime.

DLT financial instruments

The Commission's proposal included strict limits in terms of both thresholds and financial instruments that can be accepted under the DLT pilot regime. Only shares of issuers with a market capitalisation of less than EUR 200 million and bonds with an issuance size of less than EUR 500 million should be admitted to trading on or settled by a DLT market infrastructure. Moreover, sovereign bonds were excluded from the scope of the DLT pilot regime. In addition to the aforementioned individual thresholds the Commission's proposal also envisaged a total market value for DLT financial instruments settled by a DLT market infrastructure of EUR 2.5 billion.

The European Parliament proposed to expand the instruments that can be accepted under the DLT pilot regime to include DLT exchange-traded fund units and to allow DLT market infrastructures to also admit sovereign bonds to trading or record them in a distributed ledger. At the same time, however, the European Parliament proposed to lower the above individual thresholds for both shares and bonds to EUR 50 million. In contrast, the Council proposed to increase both the individual thresholds for shares and bonds and the permissible total market value, and to expand the instruments that can be accepted under the DLT pilot regime to include units in collective investment undertakings.

Interestingly, the provisional agreement on the DLT pilot regime goes beyond the proposals of the Council and the European Parliament. Accordingly, DLT financial instruments may only be admitted to trading on or settled by a DLT market infrastructure if they are

- shares of issuer with a market capitalisation of less than EUR 500 million;
- plain vanilla bonds and other forms of securitised debt, including money market instruments, with an issuance size of less than EUR 1 billion (whereby corporate bonds issued by issuers whose market capitalisation did not exceed EUR 200 million at the time of their issuance are not counted towards this threshold); or
- units in collective investment undertakings with market value of assets under management of less than EUR 500 million.

In addition, the prohibition of DLT market infrastructures to admit sovereign bonds to trading or record them on a distributed ledger has been dropped in the provisional agreement.

Furthermore, according to the provisional agreement the total market value of DLT financial instruments admitted to trading, or recorded, on a DLT market infrastructure shall not exceed EUR 6 billion. Where the recording of a new DLT financial instrument would result in the total market value reaching EUR 6 billion, the DLT market infrastructures shall not admit to trading or record such new DLT financial instrument. For completeness, it should be noted that the operator of the DLT market infrastructure must activate its 'transition strategy' for reducing, transitioning out of, or winding down its activities, including the transition or reversion of its DLT operations to

traditional infrastructures, where the total market value of the DLT financial instruments admitted to trading or recorded has reached EUR 9 billion. The Commission's proposal had envisaged 2.25 million as the threshold for activation of the transition strategy (while the Council had proposed an increase to 10 million).

Cooperation and supervision of NCAs and ESMA

In the Commission proposal, ESMA was required to issue a non-binding opinion before a NCA can grant a permission to a prospective DLT market infrastructure. The European Parliament instead proposed that the ESMA should issue a recommendation, which in contrast to an ESMA opinion is based on a comply-or-explain approach, which requires NCAs to inform ESMA whether they comply, intend to comply or do not comply with a recommendation issued by ESMA and, in case an NCA does not (intend to) comply, inform ESMA about its reasons. The reasons for non-compliance as well as any other relevant information provided by NCAs are published on ESMA's webpage.

According to the provisional agreement, the NCA shall notify ESMA of an application to operate a DLT market infrastructure as soon as it is complete. Where necessary to promote the consistency and the proportionality of exemptions granted by NCAs, or to ensure investor protection, market integrity and financial stability, ESMA may provide the NCA with a non-binding opinion on the exemptions requested by the applicant, or on the adequacy of the type of DLT used in terms of compliance with the DLT pilot regime. Where ESMA adopts an opinion, the NCA shall give it due consideration and shall, upon request, provide ESMA with a statement regarding any significant deviation from the opinion. ESMA's opinion and the NCA's statement shall not be made public.

While the involvement of ESMA may result in an intense exchange of knowledge between competent authorities, certain openness to innovation, as well as a desirable standardization across the European single market, the compromise between the Council and the European Parliament regarding the instrument to be applied by ESMA seems a bit odd. Although the opinion issued by ESMA is not intended to be binding, NCAs will nevertheless be required to provide ESMA with an explanation for any significant deviation. This gives the opinion the character of a recommendation, but without the consequence that the NCA's explanation is published. Thus, ESMA's opinion envisaged by the DLT pilot regime adopts a hybrid position between an opinion and a recommendation. For reasons of coherence, it would probably have been more straightforward to opt for one of these instruments.

Liability of DLT market infrastructures for DLT risks

In a proposal for an amendment to the DLT pilot regime's recitals, the European Parliament stressed that DLT market infrastructures should bear the liability for risks related to the functioning of the DLT they operate, notably ledger transparency risks, cyber risks and operational risks. However, this amendment was not reflected in the operational part of the DLT pilot regime. The provisional agreement takes up the European Parliament's proposal and stipulates that in case of a loss of funds, collateral or a DLT financial instrument, the operator of a DLT market infrastructure shall be liable up to the amount not exceeding the market value of the asset lost, unless it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been

unavoidable despite all reasonable efforts to the contrary. In addition, the operator of a DLT market infrastructure shall establish transparent and adequate arrangements to ensure investor protection, and provide clients with mechanisms for handling complaints and procedures for compensation or redress in cases of investor detriment as a result of serious malfunctions or of the cessation of the business due to any flaws in the functioning of the DLT or in the services and activities provided.

3. Whats next?

The provisional political agreement on the DLT pilot regime has still to be formally adopted by the Council and the European Parliament, which is expected to take place in the first quarter of 2022. It will then be published in the Official Journal of the European Union and enter into force. The DLT pilot regime will start applying nine months after entry into force, i.e. presumably in the beginning of 2023. It remains to be seen whether the DLT pilot regime will be accepted by market participants or not.

In Germany, it is not entirely clear to what extent the DLT pilot regime will extend to financial services with respect to crypto securities under the Electronic Securities Act (*Gesetz zur Einführung elektronischer Wertpapiere* – 'eWpG'), which has entered into force on 10 June 2021. This new legal framework provides for the issuance of so-called crypto securities (*Kryptowertpapiere*) using DLT and introduces crypto securities registration (*Wertpapier-registerführung*) as a new regulated financial service under the German Banking Act (*Kreditwesengesetz*). However, the keeping of a crypto securities register itself, i.e. the mere recording of ownership in the crypto securities, without the provision of any additional settlement services, does not appear to fall within the definition of DLT market infrastructure and thus should not to be in scope of the DLT pilot regime and its requirement to apply for permission. Entities operating such DLT market infrastructures, on the other hand, should be in scope of the DLT pilot regime, when providing their services in relation to crypto securities within the meaning of the eWpG.

The provisional agreement foresees a duration of the DLT Pilot Regime of three years (as opposed to the five years envisaged in the Commission's proposal). Thereafter, the Commission, based on a report from ESMA, will be required to make an assessment of the costs and benefits of extending the regime on DLT market infrastructures for another period of time, extending it to new types of financial instruments, making it permanent with or without modifications, or terminating it.

Regulatory Updates

Payments

SEPA

EPC: Reminder on implications of Brexit for all SEPA payment scheme participants

The European Payments Council (EPC) has published a reminder with regard to the measures it has previously requested the SEPA payment scheme participants to implement to ensure a continued smooth processing of cross-border payments involving a UK-based SEPA payment scheme participant after after the UK's withdrawal from the EU on 31 December 2020. This is because the respective EU and UK Funds Transfer Regulations require additional information to be sent with payments into/from the UK as the UK is now a third country under those Regulations following Brexit.

SEPA transactions to be executed or settled as of 1 January 2021 involving a UK-based SEPA payment scheme participant must contain (i) the full address details of the originator for SCT and SCT Inst transactions; (ii) the full address details of the debtor for SDD Core and SDD B2B collections. The EPC has been notified that some EEA-based SEPA payment scheme participants are not complying with the extra information requirements mandated under the EU Funds Transfer Regulation, notably regarding the need to provide the full address of the originator/debtor.

The EPC urges all SEPA payment scheme participants concerned to complete as soon as possible the identification of their customers with incoming and outgoing cross-border SEPA transactions involving both a UK and an EEA payment account, and to ensure that all customers concerned provide the necessary extra SEPA transaction data.

Date of publication: 21/12/2021

SEPA

EPC: Updated 2021 SEPA scheme rulebooks and other SEPA rules

The EPC has published updated versions of some of its 2021 SEPA scheme rulebooks and payment scheme management rules. These include:

- 2021 SEPA Direct Debit Core Scheme Rulebook (version 1.1). The version 1.1 has no specific impact on the business and operational rules compared to the version 1.0 of this Rulebook. The 2021 SEPA Direct Debit Core Scheme Rulebook version 1.1 enters into force on 11 January 2022 and remains in effect up to and including 18 November 2023;

- 2021 SEPA Instant Credit Transfer Scheme Rulebook (version 1.1). The version 1.1 has no specific impact on the business and operational rules compared to the version 1.0 of this Rulebook. The 2021 SEPA Instant Credit Transfer Scheme Rulebook version 1.1enters into force on 11 January 2022 at 08:00 CET and remains in effect up to 19 November 2023 08:00 CET;

- Maximum Amount for Instructions under the SEPA Instant Credit Transfer Scheme Rulebook (version 1.1). This document sets the maximum amount per instruction that can be processed under the SEPA Instant Credit Transfer Scheme based on the 2021 SEPA Instant Credit Transfer Scheme Rulebook version 1.1. This document is referred to in section 2.5 of that Rulebook and forms a binding supplement to it;

- 2021 SEPA Direct Debit Business-To-Business Scheme Rulebook (version 1.1). The version 1.1 has no specific impact on the business and operational rules compared to the version 1.0 of this Rulebook. The 2021 SEPA Direct Debit

Business-To-Business Scheme Rulebook version 1.1 enters into force on 11 January 2022 and remains in effect up to and including 18 November 2023;

- 2021 SEPA Credit Transfer Scheme rulebook (version 1.1). The version 1.1 has no specific impact on the business and operational rules compared to the version 1.0 of this Rulebook. The 2021 SEPA Credit Transfer Scheme rulebook version 1.1 enters into force on 11 January 2022 and remains in effect up to and including 18 November 2023; and
- SEPA Payment Scheme Management Rules (version 4.4). This version reflects the disbandment of the Scheme End-User Forum and the Scheme Technical Forum, and the creation of the Scheme End-User Multi-Stakeholder Group and of the Scheme Technical Player Multi-Stakeholder Group at the start of 2022. The version 4.4 of the SEPA Payment Scheme Management Rules enters into force as of 11 January 2022 and will remain in effect until further notice.

Date of publication: 13/12/2021

SEPA

EPC: 2021 report on payment threats and fraud trends

The European Payments Council (EPC) has published its 2021 report on payment threats and fraud trends. The document: (i) provides an overview of the most important threats and other "fraud enablers" in the payments landscape and for each threat sets out the impact, context and suggested controls and mitigations; (ii) elaborates on how the identified threats impact the payment-relevant processes; and (iii) sets out the types of fraud related to specific payment instruments and supporting schemes.

The EPC's conclusions include:

- social engineering attacks and phishing attempts are still increasing and they remain instrumental often in combination with malware, with a shift from consumers, retailers, SMEs to company executives, employees (through "CEO fraud"), PSPs and payment infrastructures and more frequently leading to authorised push payments fraud;
- malware remains a major threat, in particular ransomware has been on the rise during the past year, requiring new mitigating measures. PSP's customer relation departments should inform customers of measures including proper maintenance of own devices;
- advanced persistent threats are considered as a potential high risk for payment infrastructures and network related payment ecosystems. Measures against this should begin with security defence-in-depth strategy and architecture and also include advanced security data analytics;
- denial of service numbers are not increasing, however, they are still frequently targeting the financial sector. This is a contribution of botnets and due to the high volume of infected consumer devices, severe threats remain. To combat botnets technical countermeasures can be adopted but cybercrime dedicated laws, user awareness and enhanced cooperation is also required;
- a fraudulent payment transaction is often followed by the use of a monetisation channel such as an immediate cash withdrawal, a purchase with no trace, a money transfer or a transfer to another account ("money mulling"). Raising awareness among customers, identification of "mules" combined with monitoring and stopping measures should be adopted as mitigation actions; and
- an important aspect to mitigate the risks and reduce the fraud related to payments is the sharing of fraud intelligence and information on incidents among PSPs. However, often this is being limited by rules and regulations related to data protection, even more so in the case of cross-border sharing. It is to be expected that the new EBA Guidelines on fraud reporting will

support an improved information sharing and the availability of more accurate fraud figures.

Date of publication: 06/12/2021

SEPA

EPC: Call for change requests to the SRTP scheme rulebook

The European Payments Council (EPC) has launched a call for change requests to the SEPA request-to-pay (SRTP) scheme rulebook. Any person or organisation with a legitimate interest can submit a change request in accordance with the rules described in section 4.2.3 "Submission of Change Requests to the Secretariat" of the current rulebook version 2.0.

Date of publication: 01/12/2021

Deadline for the submission of comments: 25/02/2022

International

FSB: Survey on its work under building block 6 of the roadmap for enhancing cross-border payments

The FSB has launched a survey as part of its work under Building Block 6 of the Roadmap for enhancing Cross-border Payments, where the FSB agreed to conduct a stocktake of existing national and regional data frameworks relevant to the functioning, regulation and supervision of cross-border payment arrangements, with a view to identify issues relating to cross-border use of those data by national authorities and by the private sector. The FSB wishes to gather stakeholders' feedback in order to better understand how requirements applicable to data (e.g., where and what data must be stored/retained, where it may be transferred, the rules governing the security or access to data) could affect cross-border payments, by potentially affecting cost, speed, access, security of cross-border payments, or interoperability of cross-border payment networks.

Data frameworks within the scope of the survey include:

- domestic data frameworks, including rules, regulations, guidelines and supervisory guidance, that affect the provision of, or access to, cross-border payment services in one or more jurisdictions, or the manner in which those services utilise cross-border payments data in one or more jurisdictions;
- implementation of international standards from the FSB and other standard-setting bodies, including BCBS, CPMI, FATF, IAIS and IOSCO, if not included as part of formal domestic data frameworks; and
- other international efforts, arrangements or agreements that jurisdictions may implement in their domestic data frameworks or that may affect cross-border data flows.

The FSB invites feedback from banks, non-banks, financial market infrastructures, academics and industry associations. Responses to the survey will support FSB member authorities in the analysis of the constraints on cross-border data flows imposed by existing national and regional data frameworks.

Date of publication: 10/12/2021

Deadline for the submission of comments: 14/01/2022

FinTech/Digital finance

Germany

BaFin: Updated Guidance Notice on deposit business (*Merkblatt Depotgeschäft*)

BaFin has updated its Guidance Notice on deposit business, in particular with regard to changes introduced by the Law on electronic securities (*Gesetz über elektronische Wertpapiere – eWpG*).

Date of publication: 15/12/2021

Germany

BMF/BMJV: Revised draft Regulation on requirements for electronic securities (eWpRV)

The joint draft regulation on the requirements for electronic securities (*Entwurf einer Verordnung über Anforderungen an elektronische Wertpapiere* – 'eWpRV') of the Federal Ministry of Finance (*Bundesfinanzministerium* – 'BMF') and the Federal Ministry of Justice (*Bundesjustizministerium* – 'BMJV') has been revised on the basis of the input from the first hearing. The draft eWpRV specifies the requirements for the maintenance of electronic securities registers in accordance with the Electronic Securities Act (*Gesetz über elektronische Wertpapiere* – 'eWpG'), which entered into force on 10 June 2021.

Under the eWpG, register-keeping entities must fulfil various requirements. The draft eWpRV includes general requirements for the establishment and maintenance of an electronic securities register, the authentication instruments to be used, the accessibility of the source code used as well as requirements for cryptographic procedures and interfaces.

The draft eWpRV was essentially amended in the following points:

- requirement that a change in access to investment terms and conditions of electronic share certificates must be announced in good time and in an appropriate manner;
- simplification of the designation of the issuer if an LEI is available;
- separate definitions for participants of an electronic securities register and crypto securities register;
- enabling the identification of the person wishing to inspect the register also by fulfilling certain requirements of the German Money Laundering Act (*Geldwäschegesetz*);
- various clarifications on terms, retrieval of data and specification of time limits.

Date of publication: 14/01/2022

Germany

BaFin: Public list on crypto securities

BaFin has published a new public list on its website pursuant to Section 20(3) of the eWpG. This list consolidates information on crypto securities notified to BaFin in accordance with Section 20(1) of the eWpG. The information in the list is based on publications made by the issuers in the Federal Gazette. The list on crypto securities is intended to provide an overview of the publications associated with crypto securities.

Date of publication: 17/01/2022

EU

CoEU: Final compromise text for the DLT pilot regime

The Council of the EU has published the final compromise text of the proposed Regulation on a pilot regime for market infrastructures based on distributed ledger technology, having reached a provisional agreement with the EP. The text will now be formally adopted by the Council and the EP, at which point it will be published in the OJ. It will enter into force 20 days later and apply nine months after this date.

Date of publication: 21/12/2021

For details on the provisional agreement between the Council and the EP on the DLT pilot regime, see our 'Hot Topic' section above.

EU

EC: Strategy on supervisory data in EU financial services

The EC has published a communication on its strategy on supervisory data in EU financial services. The EC's strategy builds upon the conclusions of the comprehensive fitness check of EU supervisory reporting requirements in financial sector legislation. This strategy will contribute directly to the objectives of the European Data Strategy and the Digital Finance package to promote digital innovation in Europe. Moreover, this strategy contributes to the objectives of a Capital Markets Union and helps to achieve a single market in financial services.

There are four main building blocks in this strategy:

- ensuring consistent and standardised data that relies on clear and common terminology, as well as on common standards, formats and rules;
- facilitating the sharing and re-use of reported data among supervisory authorities by removing undue legal and technological obstacles to avoid duplicative data requests;
- improving the design of reporting requirements by developing guidelines based on best practices in applying better regulation principles in supervisory reporting; and
- putting in place joint governance arrangements in order to improve coordination and foster greater cooperation between different supervisory authorities and other relevant stakeholders, allowing them to share their expertise and to exchange information.

Date of publication: 15/12/2021

EU

EBA: Consultation on draft RTS on credit scoring and loan pricing disclosure, credit risk assessment and risk management requirements for Crowdfunding Service Providers under Article 19(7) Regulation (EU) 2020/1503

The EBA is consulting on draft RTS specifying the information that crowdfunding service providers must provide to investors under Article 19(7) of the Regulation on European Crowdfunding Service Providers (ECSPR).

The draft RTS specify:

- elements, including the format, that are to be included in the description of the method to calculate credit scoring and to suggest loan pricing;
- the information and factors that crowdfunding service providers need to consider when carrying out a credit risk assessment and conducting a valuation of a loan;
- the factors that a crowdfunding service provider must consider when ensuring that the price of a loan it facilitates is fair and appropriate; and
- the minimum contents and governance of the policies and procedures required for information disclosure and of the risk-management framework for credit risk assessment and loan valuation.

After considering feedback, the EBA expects to submit the draft RTS to the EC in May 2022.

Date of publication: 08/12/2021

Deadline for the submission of comments: 08/03/2022

EU

ECON: Reports on DORA proposal and Digital Finance Package supporting Directive

The EP has published the text of the reports, adopted by ECON, on the proposed Regulation on digital operational resilience for the financial sector (DORA) and the proposed Directive amending Directives 2006/43/EC, 2009/65/EC, 2009/138/EU, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2015/2366 and (EU) 2016/2341.

ECON adopted both reports on 1 December 2021. It set out a draft EP legislative resolution with suggested amendments to the proposed legislation. The reports have now been tabled for EP's first reading in plenary.

Date of publication: 07/12/2021

EU

CoEU: Negotiating mandate on proposed Regulation on transparency of crypto-asset transfers

The Council of the EU has announced that EU ambassadors agreed on a mandate to negotiate with the EP on a proposal to update existing rules on information accompanying transfers of funds and certain crypto-assets. This aims to introduce an obligation for crypto-asset service providers to collect and make accessible full information about the sender and beneficiary of the transfers of virtual or crypto-assets they operate. This is proposed to ensure the traceability of crypto-asset transfers, so as to be able to better identify possible suspicious transactions and if necessary block them.

The Council explains that the modifications introduced streamline and clarify the EC's proposal by:

- introducing requirements for crypto-asset transfers between crypto-asset service providers and un-hosted wallets; and
- requiring that the full set of originator information travel with the crypto-asset transfer, regardless of the transaction amount.

The Council also aims to synchronise the application of the proposal on transfer of funds and the market in crypto-assets regulation.

Date of publication: 01/12/2021

EU

ESMA: Call for evidence on the DLT Pilot Regime and review of MiFIR RTS on transparency and reporting

ESMA has published a call for evidence on the distributed ledger technology (DLT) Pilot Regime. The call for evidence seeks input from stakeholders on the use of DLT for trading and settlement and on the need for amending the RTS on regulatory reporting and transparency requirements.

The Regulation on a pilot regime for market infrastructures based on DLT requires ESMA to assess whether the RTS developed under MiFIR relative to certain pre-and post-trade transparency and data reporting requirements need to be amended in order to be effectively applied to securities issued, traded and recorded on DLT. The areas covered in the call include:

- RTS 1 (equity transparency);
- RTS 2 (non-equity transparency);
- RTS 3 (double volume cap and provision of data); and
- RTS on data reporting requirements – which are RTS 22 (transaction reporting), RTS 23 (reference data), RTS 24 (order record keeping), and RTS 25 (clock synchronisation).

In addition, in relation to the transaction reporting exemption, the call for evidence seeks stakeholders' views on possible effective ways to allow regulators' access to information on: (i) transactions; (ii) financial instruments' reference data; and (iii) transparency data. The aim is to ensure more efficient, secure, and cost-effective management of

the data stored on DLTs while preserving its quality, usability and comparability.

Based on the feedback received, ESMA will consider whether amendments to the RTS are necessary. If amendments are necessary, ESMA will consult on its proposal before submitting the final draft RTS to the EC for adoption. The DLT Pilot Regime is expected to apply in early 2023.

Date of publication: 04/01/2022

Deadline for the submission of comments: 04/03/2022

Eurozone

ECB: Opinion on proposed Regulation to extend traceability requirements to transfer of crypto-assets

The ECB has published an opinion on the proposed Regulation on transparency of crypto-asset transfers. The ECB welcomes the proposed regulation as a means of levelling the playing field for crypto-asset service providers, but calls for revisions to the proposed regulation on the following:

- Definitions. The proposed regulation should be clarified to avoid any doubt that transactions between hosted and un-hosted wallets are covered, with the effect that exactly the same information as for other crypto-asset transfers must to be collected and stored.
- Monitoring. Market developments and money laundering activities involving crypto-assets without the use of service providers or in decentralised peer-to-peer exchanges should also be closely monitored by the EC and relevant national authorities.
- Scope of the proposed regulation. The ECB understands that it is not intended to cover crypto-assets issued by central banks acting in their monetary authority capacity. However, for the sake of legal certainty and in order to fully align the scope of the proposed regulation with that of the proposed MiCA regulation, the ECB proposes to explicitly indicate this in the recitals and provisions of the proposed regulation.
- Reference to currencies. It is not appropriate to make reference in a Union legal text to 'fiat currencies'. Rather, the proposed regulation should refer instead to 'official currencies'.
- The Regulation should apply from the same date as MiCA. This would be helpful from a systemic and financial stability perspective in order to ensure that the proposed regulation applies to crypto-asset transfers sooner rather than later, instead of waiting for the coming into operation of the rest of the AML package.

Date of publication: 01/12/2021

International

IOSCO: Consultation report on the use of innovation facilitators in growth and emerging markets

IOSCO has launched a consultation on proposed recommendations on the use of innovation facilitators in growth and emerging markets. The consultation covers three types of innovation facilitators (IFs): innovation hubs, regulatory sandboxes, and regulatory accelerators.

IOSCO's consultation presents: (i) definitions and the risks and opportunities posed by IFs; (ii) the global trends and an overview of emerging markets' regulatory initiatives; (iii) examples of the current practices in advanced markets; and (iv) also discusses the role of conducting a policy assessment in developing IFs.

IOSCO proposes four recommendations for emerging market member jurisdictions to consider when setting up innovation facilitators, which cover:

- considerations prior to the establishment of innovation facilitators;
- definition and disclosure of objectives and functions of innovation facilitators;
- defined eligible entities and the criteria for application; and

- mechanisms for cooperation and exchange of information with both local and foreign relevant authorities.

The report also includes a decision tree for regulators to consider when looking at establishing an innovation facilitator and assessing what type of innovation facilitator to set up.

Date of publication: 07/12/2021

Deadline for the submission of comments: 06/02/2022

News from the Courts

Payments

Germany

German Federal Court of Justice, decision of 02/06/2021 – 3 StR 61/21 (Criminal liability for unauthorised Hawala banking)

The decision of the German Federal Court of Justice (*Bundesgerichtshof* – 'BGH') relates to 'Hawala-Banking', which is an informal payment system based on mutual trust: A person deposits money with an intermediary, who then authorizes a local partner to pay the amount to the recipient. The intermediaries' debts are later settled internally. The accused was a member of such a Hawala network, offering – without a licence from BaFin – his payment services and collected funds from customers in southern Germany and forwarded them within the network. For communication, members of the network used chat groups on WhatsApp.

Against this background the BGH held:

- Transfers of funds within the framework of a Hawala system generally constitutes money remittance pursuant to Section 1(1) sentence 2 no. 6 of the Payments Services Act (*Zahlungsdiensteaufsichtsgesetz*), which requires a licence from BaFin.
- An organization that operates a Hawala system without BaFin licence may be a criminal organization within the meaning of Section 129(2) of the Criminal Code (*Strafgesetzbuch*). Whether there is an overriding common interest in the continued existence of the Hawala system that goes beyond individual interests, which would be required for such a system to be classified as a criminal organization, depends on the specific circumstances of the individual case.
- The repeated provision of money remittance services as part of a single business constitutes only one act in the legal sense. Therefore, the offence of unauthorized provision of payment services can be committed only once, even in the case of repeated acts.

EU

European Court of Justice, judgement of 02/09/2021 – C-337/20 (Liability of the payment service provider for unauthorized payment transactions)

A French bank granted a current account credit facility to a customer and, following its termination, brought proceedings against the guarantor for payment. The guarantor maintained that, by making transfers to third parties without the authorisation of the debtor, the bank had breached its duties and that the amount of those transfers should be deducted from the sums claimed from him. The French Court of Appeal held that the guarantor's objections were inadmissible, since he had not respected the 13-month period laid down for this purpose under Article L. 133-24 of the Monetary and Financial Code ('MFC'), which is based on Article 58 of PSD1. The guarantor challenged the decision before the *Cour de Cassation*, maintaining that the immediate repayment of unauthorised payment transactions reported by a payment service user to a bank, laid down in Article L. 133-18 of the MFC (which transposes Article 60(1) of PSD1 into French law), does not preclude that bank from being held liable under the general law where it has breached its duty of care. The *Cour de Cassation* referred the case to the European Court of Justice ('ECJ') for a preliminary ruling.

The ECJ considered that the liability regime for payment service providers laid down in Article 60(1)

and Article 58 of PSD1 has been the subject of full harmonisation, with the result that the Member States cannot maintain a parallel liability regime in respect of the same operative event. It follows that a competing liability regime which would allow the payment service user to trigger the liability of the provider of such services for that transaction beyond the period of 13 months and without having notified the unauthorised transaction concerned would be incompatible with PSD1.

In contrast, a contract of guarantee between a payment service provider and a guarantor is not governed by PSD1. In that regard, the possibility for the guarantor to rely on the provisions of national law to reduce his or her obligations toward the creditor benefiting from the guarantee, in the event of negligence on the part of that creditor in the execution of a payment transaction, does not affect in any way the contractual relationship established between the creditor and the debtor, respectively, the payment service provider and the user of such services, which, for its part, is governed by the provisions of PSD1.

In light of the above, the ECJ held that

- Article 58 and Article 60(1) of PSD1 must be interpreted as precluding a payment service user from being able to trigger the liability of the provider of those services on the basis of a liability regime other than that provided for by those provisions, in the case where that user has failed to fulfil his or her obligation to notify laid down in that Article 58;
- Article 58 and Article 60(1) of PSD1 must be interpreted as not precluding the guarantor of a payment service user from relying, by reason of a failure on the part of the payment service provider to fulfil its obligations relating to an unauthorised transaction, on the civil liability of such a provider, which is entitled to the guarantee, in order to challenge the amount of the guaranteed debt, in accordance with a contractual liability regime under the general law.

FinTech/Digital finance

Germany

German Federal Court of Justice, judgement of 09/09/2021 – I ZR 113/20 (Permissibility of an online generator for legal documents)

The defendant is a publishing house specialising in legal literature that offers online a digital generator for drafting contracts and other legal documents, which customers can purchase by subscription or by individual purchase. For this purpose, customers are asked various questions, which they must answer, predominantly in multiple-choice mode. Based on the answers given, contractual clauses are generated from a collection of text modules with the help of the software, which are then compiled into a draft contract. The plaintiff, a bar association, complained about an unauthorized legal service and sued the defendant for injunctive relief.

The BGH held that the creation of a draft contract with the help of a digital generator for legal documents is not a legal service within the meaning of Section 2(1) of the German Legal Services Act (*Rechtsdienstleistungsgesetz*), i.e. an activity that relates to specific matters of others and requires a legal assessment of the individual case. The defendant's activity consists in the creation of draft contracts with the help of a programmed software made available online on the basis of the user's specifications. In doing so, it does not act in a specific matter of the user. The defendant programmed the software on the basis of conceivable typical circumstances for which it developed standardized contract clauses in anticipation of the answers given. The user's individual circumstances, which go beyond the standard case, would not be taken into account in the creation of the draft contract - similar to a form manual. The user did not expect a legal

examination of his specific case, as would be required for a legal service.

Germany

Regional Court of Dresden, decision of 18/05/2021 – 17 Qs 9/21 (Confiscation of proceeds of crime at a crypto exchange)

In this criminal case, the Regional Court of Dresden held that an asset freeze imposed on a crypto exchange is unlawful and must be revoked if there is "a paid transaction that precludes the confiscation of the proceeds of the offense from anyone other than the perpetrators of or participants in the criminal offense".

Under German law, law enforcement authorities may confiscate assets arising from criminal acts. Such confiscation is possible not only for the perpetrator who has obtained something directly from or for a criminal act. Pursuant to Section 73b(1) of the German Criminal Code (*Strafgesetzbuch*), any third party may also be affected by such a confiscation measure, provided that the acquired assets were transferred to it free of charge or without legal reason or that it recognized or should have recognized that the assets were derived from an unlawful act.

According to the Dresden Regional Court, for a standard business model of a crypto exchange the requirements for a third-party seizure are regularly not met. Accordingly, seizure measures are not possible as long as law enforcement authorities do not succeed in proving that the exchange is involved in or must have known about the (alleged) criminal acts of their users. This is because the retention of a fee by crypto exchanges establishes the "paid character" of the exchange service. This means that seizure is no longer possible because a third party – in this case the crypto exchange – has not received any assets with a (potentially) criminal background free of charge or without legal ground".

For the avoidance of doubt, the court decision does not concern the confiscation of crypto assets itself, but rather the confiscation of fiat money.

Germany

Higher Regional Court of Düsseldorf, decision of 19/01/2021 – 7 W 44/20 (Foreclosure in crypto assets)

By default judgment of the district court, the debtor was ordered to transfer 0.9 BTC to the wallet address of the creditor. The creditor argues that the debtor's obligation can be fulfilled by him or any third party acquiring 0.9 Bitcoin against payment and transferring it to his - the creditor's - wallet address. The district court rejected this application for enforcement. The debtor's obligation was an action that may not be taken by others pursuant to Section 888 of the Code of Civil Procedure (*Zivilprozessordnung* – 'ZPO') since the transfer of Bitcoins required knowledge of the location of the transferor's private key, which a third party does not have. With the immediate appeal to the higher regional court the creditor continued to pursue his application.

The key question of the decision was whether the debtor's obligation to transfer Bitcoin is an action that may be taken by others or not. The distinction is crucial as the choice of enforcement measures depends on the correct qualification of the action. While enforcement of actions that may be taken by others follows Section 887 ZPO, actions that may not be taken by others are enforced in accordance with Section 888 ZPO. The qualification of a Bitcoin transfer is highly controversial in the legal literature and, as far as can be seen, no court decisions have been published on this subject so far.

The court found the creditor's immediate appeal to be well-founded and qualified the transfer of Bitcoins as an action that may be taken by others pursuant to Section 887 ZPO. In its reasoning, the court stated that it was economically irrelevant for the creditor by whom and in what way the crediting of Bitcoins in his wallet was brought about. It is not apparent from the creditor's complaint that the Bitcoin had to originate from a wallet of the debtor and could not have been procured elsewhere, for example via the bitcoin.de platform. Rather, the creditor's complaint referred to the transfer of

Bitcoins of "the same type, quality and quantity" and not to the specific Bitcoins in the debtor's wallet.

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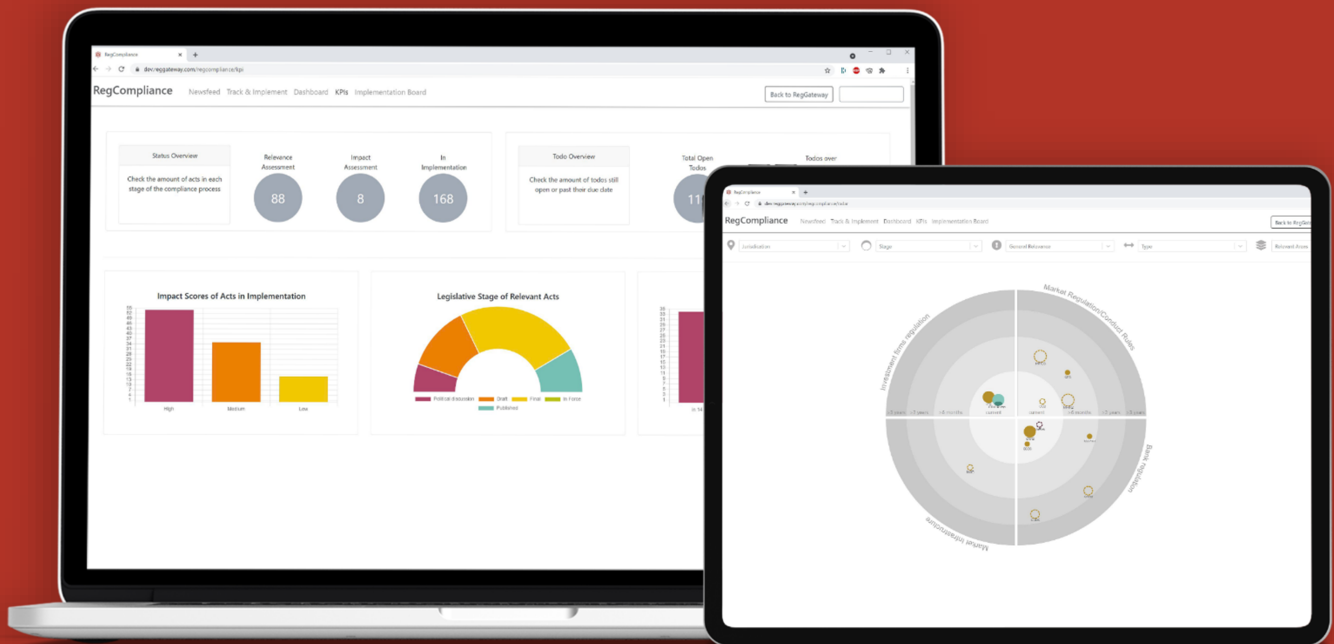

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