

**Ms Mairead McGuinness
Commissioner for Financial
Services, Financial Stability and
Capital Markets Union
European Commission**

**Irene Tinagli
Chair of the Committee on
Economic and Monetary Affairs
European Parliament**

**Vincent van Peteghem
President of the Economic
and Financial Affairs Council
Council of the European Union**

Ref: DLT Pilot Regime Implementation

Dear Mrs McGuinness, Mrs Tinagli and Mr Van Peteghem,

I am writing to you today to provide you with an update on the uptake of distributed ledger technology by financial market infrastructures in the context of the DLT Pilot Regime (Regulation (EU) 2022/858¹).

According to Article 15 of this Regulation, ESMA is required to publish annual interim reports to: (i) provide market participants with information on the functioning of the markets, (ii) address incorrect behaviour of operators of DLT market infrastructures², (iii) provide clarification on the application of the Regulation and (iv) update previous guidance based on the evolution of distributed ledger technology. The first such report was expected to be published by 24 March 2024.

Given that, as of the entry into application of the DLT Pilot Regime on 23 March 2023, no DLT market infrastructures have been authorised yet, ESMA does not intend to publish a report. However, following discussions with staff of the European Commission, we would like to update you on the status of the applications submitted so far, and to highlight the main

¹ 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, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU

² The DLT Pilot Regime provides the legal framework for trading and settlement of transactions in crypto-assets that qualify as financial instruments under MiFID II (DLT financial instruments). The DLT Pilot Regime facilitates the set-up of new types of market infrastructures, such as DLT multilateral trading facilities (DLT MTF), DLT settlement systems (DLT SS), as well as combined DLT trading and settlement systems (DLT TSS). In addition to established investment firms, market operators or CSDs, new entrants may also apply for the DLT Pilot Regime.

challenges we have observed during our interactions with the national competent authorities (NCAs) and (potential) applicants.

As of today, four official applications³ have been submitted. These applications are currently under assessment by the respective NCAs, who have also raised questions arising from the applications for discussion at ESMA's DLT Working Group⁴. Around eight other potential applications⁵ may be submitted during the course of this year.

With one year of experience navigating the Pilot Regime, one of the conclusions by ESMA is that the novelty of this particular regime may explain its relatively slow uptake. In addition, we have identified some challenges which we are listing in an annex to this letter, for further consideration by the relevant Commission services. It would be worthwhile if the Commission could clarify some aspects to support the increased uptake of the regime, such as those related to innovative solutions for cash settlement, the use of self-hosted wallets, the scope and the thresholds of admitted DLT financial instruments, and last but not least, the duration of the DLT Pilot Regime.

Should you or your colleagues want to discuss the points raised in the annex or require any further detailed information please do not hesitate to contact me or Carsten Ostermann, Head of the Market and Digital Innovation Department (carsten.ostermann@esma.europa.eu).

Yours sincerely,

[signed]

Verena Ross

CC: Thérèse Blanchet, Secretary-General of the Council of the European Union

John Berrigan, Director-General, DG Financial Stability, Financial Services and Capital Markets Union, European Commission

Claudia Lindemann, Head of the Secretariat of the Committee on Economic and Monetary Affairs, European Parliament

³ One DLT TSS and one DLT MTF in Germany, one DLT SS in the Czech Republic, and one DLT TSS in the Netherlands

⁴ Made up NCAs, ESMA, the ECB and the European Commission

⁵ From France, Germany, Lithuania, Poland and Spain

ANNEX

Identified challenges related to the implementation of the DLT Pilot Regime

i. Innovative solutions for cash settlement

In the absence of central bank digital currencies, a significant challenge but also an opportunity provided by the DLT Pilot Regime is the possibility to use innovative solutions for cash settlement that do not involve traditional cash. For example, DLT market infrastructures can accommodate the use of cryptographically-secured settlement solutions, such as tokenised versions of commercial bank money or e-money tokens (as defined in MiCA⁶). However, given the timing mismatch with MiCA authorisations that will only start this year, it has been difficult for DLT Pilot Regime applicants to find cash leg providers (commercial banks or e-money token issuers).⁷ Pending further clarification by the Commission, according to the DLT Pilot Regime, a DLT SS/TSS operator benefitting from the exemption in Article 5(8) can settle payments using e-money tokens only if they are issued by credit institutions, and not by e-money institutions, which we understand several (potential) applicants are envisaging.

ESMA welcomes the Eurosystem initiative⁸ to organise trials and experiments in 2024 for central bank money settlement of wholesale financial transactions recorded on DLT platforms. However, we understand that, given the short duration and the focus on wholesale solutions, this initiative would not represent a long-term solution for the DLT Pilot Regime at this stage.

ii. Custody through self-hosted wallets

While bearing in mind the difference in the scope of the DLT Pilot Regime (a subset of financial instruments as defined under MiFID II) and MiCA (crypto-assets that are not classified as financial instruments, including e-money tokens), we also note that the regulatory expectations for custody services in the context of the DLT market infrastructures and the specific roles and responsibilities of the various entities involved, in particular regarding the scenario of “self-hosted wallets” (non-custodial wallets under MiCA), may deserve further clarifications, including to what extent there may be an overlap with custody services under MiCA or MiFID II.

iii. Interoperability

Another important challenge is related to the interoperability between DLT market infrastructures and traditional market infrastructures, as well as among DLT market infrastructures themselves. As such, it is burdensome for DLT MTF operators to find a DLT TSS or DLT SS (since none have been authorised yet) or to have access to a traditional CSD (given technological and operational complexities). This is relevant in particular for meeting the

⁶ Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937

⁷ Issuers of e-money tokens (EMTs) would not be able to apply for a MiCA authorisation until end-June 2024, and even then, the speed with which such an EMT settlement solution would become available to DLT market infrastructures depends on the speed with which competent authorities authorise those providers.

⁸ [Exploratory work on new technologies for wholesale central bank money settlement \(europa.eu\)](https://www.europa.eu)

requirement under Article 3(2) of CSDR according to which transferable securities traded on a trading venue should be recorded in book-entry form in a CSD.

iv. Investor protection (including the scope of DLT financial instruments)

By way of exception to the “obligation of intermediation” under MiFID II (recital 26), the DLT Pilot Regime enables NCAs to authorise access to a DLT market infrastructure for retail investors under certain conditions, including possible additional “compensatory measures” required by the competent authority to provide investor protection safeguards. In light of the complex interaction between the MiFID II and the DLT Pilot Regime and the investor protection implications of the direct access, the identification of sound and convergent compensatory measures may be challenging, however ESMA will continue working with the NCAs in this respect.

Furthermore, the direct access of retail investors to DLT market infrastructures warranted the limitation of the financial instruments admitted to trading to non-complex financial instruments (recital 23 of the DLT Pilot Regime). While the DLT Pilot Regime seems to cross refer to the analogous category of MiFID II instruments for the purpose of the “execution-only” regime, requests for further clarity have been made to avoid inconsistency in the implementation of the DLT Pilot Regime across the EU. ESMA has submitted a Q&A to the Commission on this topic, given that it requires interpretation of Union law.

In addition, further clarity might be needed on the treatment of pre-emptive subscription rights attached to the shares admitted to trading and/or recorded on DLT market infrastructures.

v. Competitiveness vis-à-vis third-country regimes

An important contributor to the success of the DLT Pilot Regime is its attractiveness compared to similar regimes in jurisdictions outside of the EU. A major source of hesitation for potential applicants is the uncertainty about the duration of the DLT Pilot Regime. Given the late start and the dissuasive effect of the perceived time limit of the application of the DLT Pilot Regime, it would be helpful if the Commission were to clarify publicly as soon as possible that the DLT Pilot Regime will be extended beyond the potential additional three years from 2026 (per Article 14). This would send a signal to market participants that they have sufficient time to implement and operate their projects, making the required investments worthwhile for them.

Another element that may undermine the competitiveness of the DLT Pilot Regime is the low thresholds for the DLT financial instruments that are admitted to trading on a DLT market infrastructure or that are recorded on a DLT market infrastructure. While the thresholds mandated in Article 3 are clearly in line with the ‘experimental’ nature of the DLT Pilot Regime, further flexibility in this respect would likely attract more applicants.