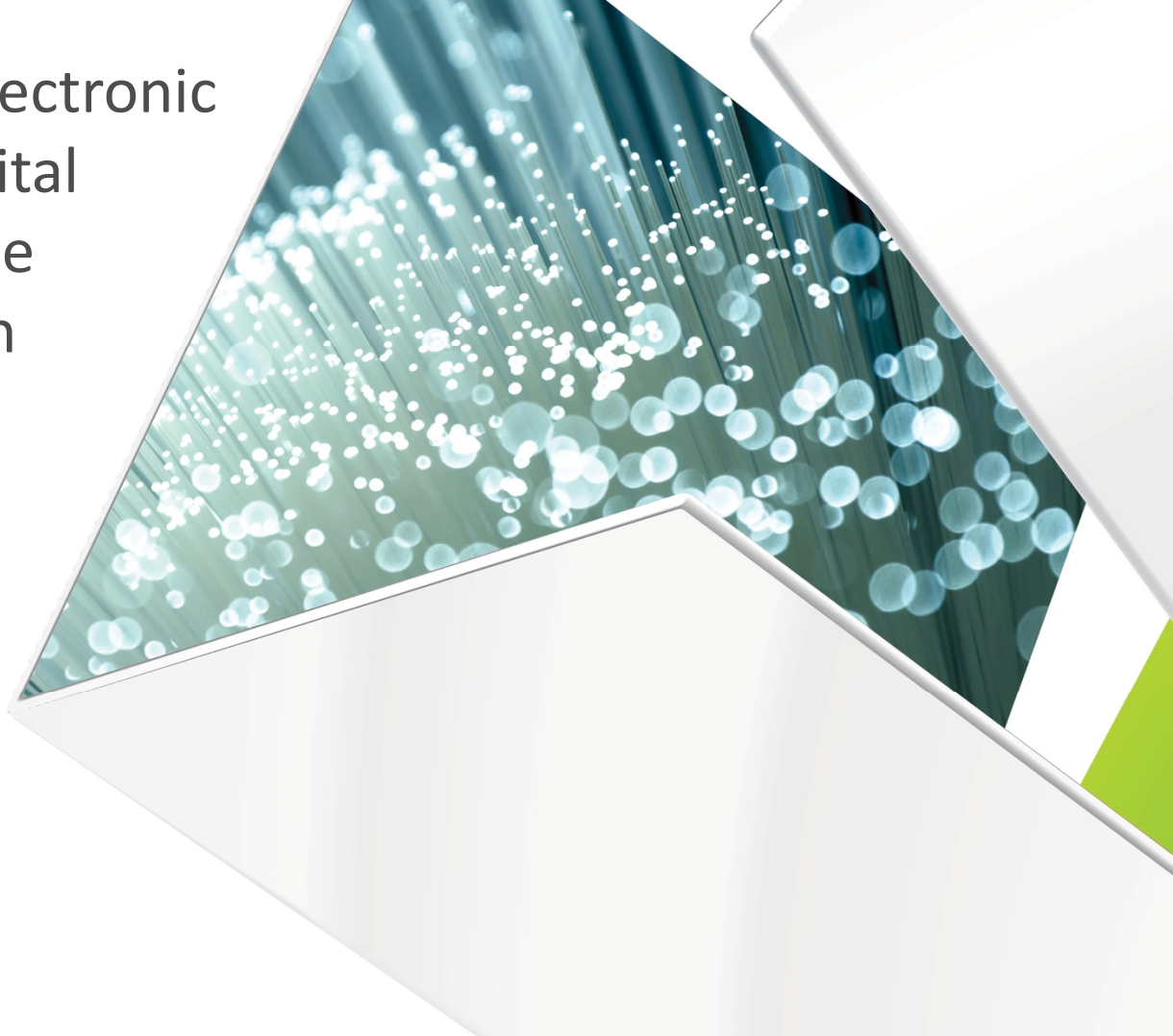# The introduction of electronic securities and the Digital Finance Strategy of the European Commission

DCM Breakfast Briefing

Frankfurt, 14 January 2021

Hogan Lovells

Agenda

- Overview and timeline of initiatives of the German and EU legislators

- Electronic securities according to the draft German Act on Electronic Securities (eWpG-E)

- Amendments of further German laws (DepotG, WpPG and KWG)

- Amendment of MiFID II and Regulation on Markets in Crypto-assets (MiCA)

- EU pilot regime for DLT based market infrastructures

Timeline and Overview

Initiatives of the German and EU legislator

- Draft law of the German government of 14 December 2020 – Draft Law on the Introduction of Electronic Securities (Government Draft)[*)]

  – Act on Electronic Securities (*Gesetz über elektronische Wertpapiere - eWpG*)

  – Amendments to the Safe Custody Act (*Depotgesetz – DepotG*) and other acts

- EU Commission's Digital Finance Package[**)]

  – Digital Finance Strategy for the EU (COM(2020) 591 final)

    – Proposal for a regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 (MiCA)

    – Proposal for a regulation on a pilot regime for market infrastructures based on distributed ledger technology (DTL) (Pilot Regime)

    – Proposal for a regulation on digital operational resilience for the financial sector and amending regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014 and (EU) No 909/2014 (DORA)

    – Proposal for 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 (Amendment directive)

  – Retail Payments Strategy for the EU(COM(2020) 592 final)

[*)] Available under: ttps://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/Dokumente/RegE_Einfuehrung_elektr_Wertpapiere.pdf;jsessionid=39BBBDA7F0CFEF19301F17BA660B7FC0.2_cid324?___blob=publicationFile&v=3
[**)] Available here: https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en

Timeline of German and EU legislative procedures

Legislative initiative	2020				2021				2022				2023				2024			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
German Draft Law on the Introduction of Electronic Securities				◆		◆ *)														
MiCA Regulation				◆													◆			
Regulation on a Pilot Regime				◆													◆			
DORA-Regulation				◆						◆										
Amending Directive (u.a. MiFID II)				◆						◆										

◆ Publication date Draft ◆ Expected date of entry into force

*) The current legislative period ends on schedule in Q3 2021. Accordingly, the procedure is expected to be completed by summer 2021.

Comparison of the objectives of German and EU legislator

Government Draft, inter alia eWpG

- Modernization of German securities law and strengthening of Germany as a financial center

- Creation of a legally secure regulatory framework and corresponding supervisory structures

- Increasing the security of technological innovations and innovation in the financial sector

EU Digital Finance Strategie

- **A Digital Single Market for financial services**

- **A regulatory framework facilitating innovation**

- **A European financial data space to promote data-drive innovation**

- **Addressing the risks of digital transformation**

Target of the EU Digital Finance Strategie (extended)

A Digital Single Market for financial services

- Enabling EU-wide interoperable use of digital identities
- Facilitating the scaling up of digital financial services across the Single Market

A regulatory framework facilitating innovation

- Enabling EU markets in crypto-assets and tokenised financial instruments
- Promoting cooperation and the use of cloud computing infrastructure
- Promoting investments in software by adapting prudential rules on intangible assets
- Promoting the uptake of artificial intelligence tools
- Ensuring a future proof legislative framework on an on-going basis

A European financial data space to promote data-drive innovation

- Facilitating real-time digital access to all regulated financial information
- Promoting innovative IT tools to facilitate reporting and supervision
- Promoting business-to-business data sharing in the EU financial sector and beyond (open finance)

Addressing the risks of digital transformation

- Safeguarding financial stability, protecting investors and consumers, based on the "same activity, same risk, same rules" principle
- Protecting consumers and the public interest
- Strengthening digital operational resilience

Subject of the Government Draft – among others eWpG

Changes to Safe Custody Act (DepotG)

Changes to Securities Trading Act (WpHG)

Changes to Covered Bond Act (PfandBG)

Changes to Banking Act (KWG)

Changes to Act on Debt Securities (SchVG)

Act on Electronic Securities ("eWpG")

Changes to Stock Exchange Act (BörsG)

Changes to Audit Report Regulation (PrüfbV)

Changes to Act on Financial Supervision (FinDAG)

Changes to Investment Code (KAGB)

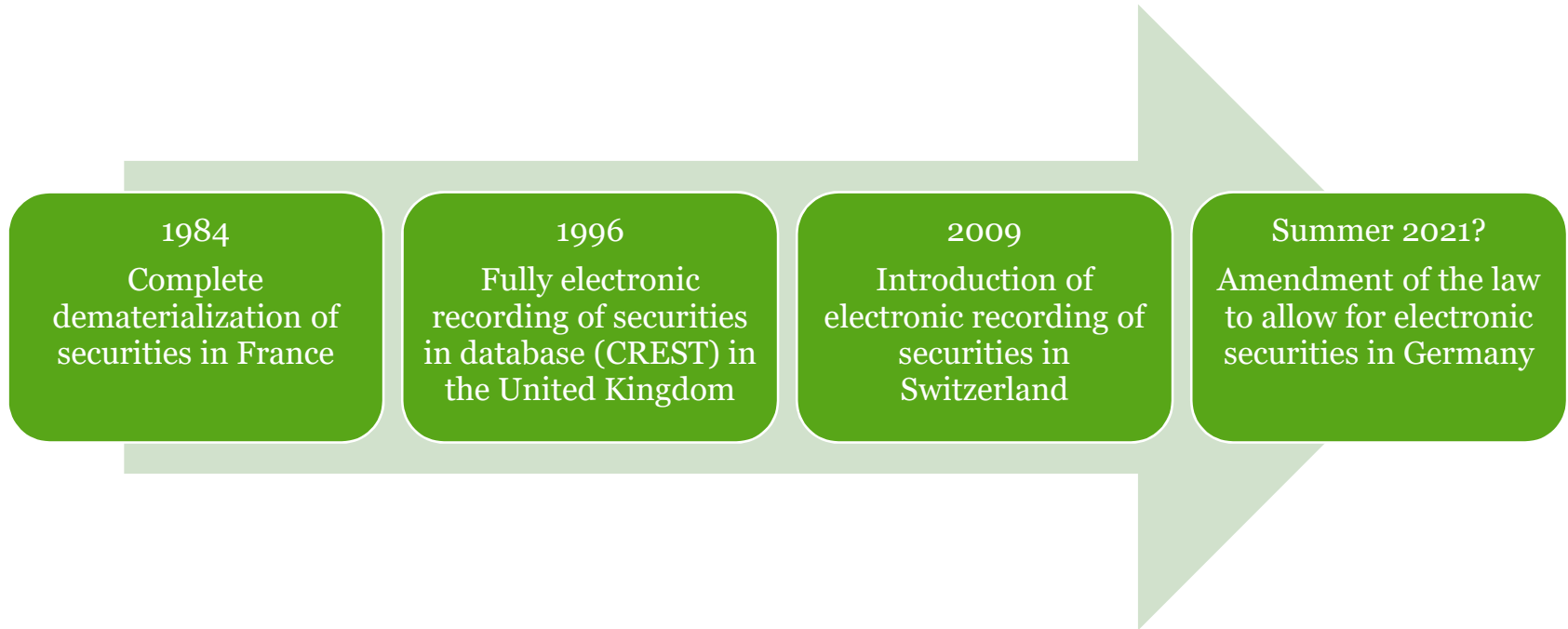Regulation on cost and charges increases

Subject of the Digital Finance Strategy

MiCA (EU-Pass)	Pilot Regime	Amendment directive	DORA	
				Legislative proposal published
Harmonization of the Customer Due Diligence (CDD) in the context of the revision of the rules on anti money launderung and terrorist financing	Interoperable cross-border framework for the use of digital identities; revision eIDAS-Regulation	Adjustment of capital requirements to encourage investments in software by banks (adoption of RTS)	Legislative measures relating to the acceptance of digital payments (KMU, public administration)	Legislative proposal announced
Additional rules for licensing and EU-Passport for issuers of crypto assets and crypto services (like Crowdfunding-Regulation)	Regulatory guidance for the use of KI-Applications; KI-legal framework	Introduction of a central bank digital currency (CBDC)	Review PSD 2 and alignment framework of PSD 2 and EMD2	
Disclosure infrastructure – amendments to EU financial services legislation (machine-readable format)	Adaptation of the legal framework for financial services from the perspective of consumer protection and supervisory regulations	Framework for open finance	Potentially, legal act on mandatory accession for payment service providers to the SCT Inst. Scheme	

Electronic securities under the eWpG-E

Development compared to other European jurisdictions

1984

Complete dematerialization of securities in France

1996

Fully electronic recording of securities in database (CREST) in the United Kingdom

2009

Introduction of electronic recording of securities in Switzerland

Summer 2021?

Amendment of the law to allow for electronic securities in Germany

Scope of the eWpG

- In Scope
  - Bearer debt securities, e.g.
    - Bonds
    - Covered bonds
    - Certificates
    - Warrants
  - Corresponding application to electronic investment share certificates under the German Investment Code (*Kapitalanlagegesetzbuch* – KAGB) that are issued in bearer form (Section 95 (1) and (3) KAGB-E, new in the Government Draft)
- Out of Scope
  - Shares
  - Registered securities and instruments payable to order
  - Consignment bill (*Ladeschein*), warehouse certificate (*Lagerschein*) and bills of lading (*Konossement*)

Basic types of electronic securities

Central register security	Crypto security

```
        Central register security              Crypto security
                  ↓                                  ↓
        ┌─────────────────────┐          ┌─────────────────────┐
        │ Centralised register │          │ Decentralised register │
        └─────────────────────┘          └─────────────────────┘
         │                │                │         │        │
   Central securities   Custodian         DLT    New Tech  New Tech
   depository bank
```

Central register security

Central register security → Centralised register

Centralised register
- Central securities depository bank
- Custodian

Crypto security → Decentralised register

Decentralised register
- DLT
- New Technology
- New Technology

Registrar

Central register security	Crypto security

Central register for electronic securities (Section 12)

- Authorised central securities depository which provides domestically (in Germany) the core services listed in Section A of the Annex to the Central Securities Depository Ordinance (Regulation (EU) No 909/2014 - CSDR) (*Wertpapiersammelbank*)

or

- Person authorised to conduct custody business domestically (in Germany) (custodian); requires express authorisation of the issuer

- For electronic securities that are to be traded on a stock exchange or another trading venue within the meaning of the CSDR, custody with the CSD is required under Union law either way

Crypto securities register (Section 16)

- Entity which is designated as such by the issuer vis-à-vis the holder

- The issuer may act as registrar itself (in the absence of a designation, the issuer is deemed to be designated) or instruct a service provider

- No authorized (central) securities depository required; management and constant updating of the register can be carried out automatically and algorithm-based

- License requirement according to Section 1 (1a) sentence 2 No. 8 KWG (new) (Crypto Securities Registry)

- Special technical requirements apply (Section 16 (1)), in particular a (decentralized) recording system (Section 4 (11)) is required

Electronic securities as a thing (Sachen)

- Electronic securities are deemed to be a thing (*Sache*) within the meaning of Section 90 BGB by virtue of legal fiction pursuant to Section 2 (3) eWpG (first fiction of an intangible asset as a thing in German civil law; unlike, for example, federal debt securities)

- All rules on the protection of property in rem automatically apply in order to provide the person authorized of electronic securities with the same comprehensive level of protection as the owners of certificated securities

  – The protection of property extends in particular to cases of enforcement or insolvency

  – In order to take into account the special features of electronic securities in single name entry, special rules are provided for dispositions, including transfer of ownership (Sections 24 and 25 eWpG), and in particular acquisition in good faith (Section 26 eWpG) and presumption of ownership for the holder (Section 27 eWpG)

  – For the collective registration, this is done in accordance with Section 6 (2) BSchuWG by equating the registration with a collective securities holding (Section 9 eWpG).

- The legislator emphasizes that with the factual fiction no decision has been made on the question whether electronic securities are to be declared a new *sui generis* right; rather, this decision is to be reserved for a potential comprehensive reform of the German securities and custody law

- Criticism: benefit doubtful; rules of property law unsuitable for intangible securities; example pledge and bona fide acquisition of co-ownership shares

Transfer of ownership

Single name entry (Section 8 (1) No 2)

– Concerns Central Register Securities and Crypto Securities in single name entry

– Requirement of registration or transfer (Section 24) as a surrogate for creation of possession (cf. Section 27 / Section 1006 (1) sentence 1 BGB); also applies to assignments of rights from the security under Section 398 BGB (see reasoning)

– Transfer of ownership requires agreement and transfer on the instructions of the person authorized to dispose (Section 25 sub-section 1 is a special provision to Section 929 sentence 1 BGB)

– Acquisition in good faith (Section 26)

– Presumption of ownership (Section 27)

=> The disposition outside the register is not possible (high disposition transparency)

Collective entry (Section 8 (1) No 1)

– Requires deposit in collective safe custody (i.e. registration with a central security depositary bank or custodian)

– Reference in Section 9 to DepotG, in particular Section 1 (1) sentence 3 DeptoG (new) (see following slides)

– Disposal of share in co-ownership (*Miteigentumsanteil*) (Sections 9b DepotG (new) in connection with Section 6 DepotG)

– Acquisition by command (*Geheißerwerb*) according to Section 929 sentence 1 BGB, acquisition of possession by conversion of the intent to take possession

– No legal effect of the booking in the computer of the intermediary banks (indication only)

=> No difference between collective holdings based on certificates and those based on electronic securities

The issuance of electronic securities in detail

- Subscription agreement, purchase agreement or similar

- Terms and conditions to be made directly available to the public at the registrar in form of a permanent electronic document, which can be directly and repeatedly accessed by anyone (*Niederlegung*, Section 5 (1))

  - Section 5 is not applicable to electronic investment share certificates within the meaning of the KAGB, as publication obligations for investment conditions of mutual funds and information rights for special funds already exist

- Definition of the essential information about the securities required for entry (Section 13 or Section 17)

- Entry in the register (Section 4 (4))

- Publication of information in the Federal Gazette without undue delay after entry (Section 20, crypto securities only)

- Preparation of register extracts after entry (Section 19, crypto securities only)

Comparison of different types of securities

	Security (certificate)	Central register security	Crypto security
Signing / registration	Signing of a deed (*Skripturakt*)	Entry in a <u>centralised securities register</u> (Section 2 (1); Section 4 (2))	Entry in a <u>crypto securities register</u> (Section 2 (1); Section 4 (3))
Holder / Autho-rization	Holder / in the case of collective holdings, the person named on the deposit certificate (Section 6 DepotG new)	The holder is the person who is registered as the holder of the electronic security or a <u>specific share</u> in a total issue (Section 3(1)); The authorized person is the person who holds the right arising from the electronic security (Section 3(2))	
Forms of entry	N/A / Custody book (Section 14 Safe Custody Act (*DepotG*))	- Collective entry is made in the name of a <u>central securities depositary bank</u> or a <u>custodian</u> (Section 8 (1) no 1) - entry in the name of a single person or entity (Section 8 (1) no 2)	
Availability	N/A / Securities account statement	Participants' right of inspection (Section 10; Section 15 (1) No 5)	- Participants' right of inspection (Section 10; Section 23 (1) No 8) - Extract from the register for the holder (Section 19) - Publication Federal Gazette (Section 20)
Substitution	Substitution of electronic securities by certificated securities possible with consent or if provided for in the terms of issue without consent (Section 6 (2))	- Basically, consent required (Section 6 (4)) - In the case of collective safe custody, substitution by a central register security is possible (Section 6 (3)), if entry is made in the name of and with a central securities depositary bank	The replacement of a security issued by means of a certificate by an electronic security requires the express consent of the authorized person (Section 6 (4))
Settlement	Delivery of individual certificates (usually held in custody) / inclusion of collective holdings in the system for transfer via book-entry (*Effektengiro*)	- Inclusion of collective holdings in the *Effektengiro*, if security is registered in the name of a CSD (Section 12 (3)) - No inclusion possible in case of entry in the name of a custodian	Recording in *Effektengiro* currently not foreseen (see also Art. 3 CSD Regulation)

Transparency of crypto securities

- Availability of an extract from the register in text form for <u>individually registered</u> crypto securities (Section 19):

  - At the request of the holder where necessary for the exercise of rights ((1))

  - For consumers: (i) upon entry, (ii) whenever there is a change in the contents of the register, and (iii) annually ((2))

- Publication in the Federal Gazette by the issuer of a crypto security (Section 20):

  - When the registration takes place

  - In case of change of the issuer

  - In case of a change to the information on the crypto securities register

  - In case of change of the registrar

  - In case of change to the essential content of the right (including identification number and label)

  - Change to the date of entry and date of change

  - Change to the information whether it an entry or an amendment is concerned

Special rights and obligations in case of crypto securities

- Requires tamper-proof recording system in which data is logged in time sequence and stored in a manner protected against unauthorized deletion and subsequent alteration (Section 16)

    – Recording system (Section 4 (11)) is a decentralized association with control rights distributed according to a predefined pattern

- Obligation of issuers to take appropriate technical and organizational measures to ensure the required integrity and authenticity during the entry period (Section 21)

    – Fulfillment through special purpose entities ("**SPVs**") as issuers?

    – Involvement of other companies involved in the issue and sale of the securities?

- Right of extraordinary termination if the issuer fails to restore the functionality of the register within a reasonable period of time set by the security holder (Section 30)

    – The issuer of crypto securities on the one hand and the company operating the crypto securities registry on the other hand are not necessarily identical (or not even part of the same group)

    – Questionable whether the issuer in this case can effectively effect the necessary arrangements

Responsibilities and liability

- Registrar

  – is a guarantor of the integrity of the procedure used for the status as security of electronically issued securities (see reasoning to Section 4 (10))

  – must ensure that confidentiality, integrity and authenticity of the data are guaranteed (Section 7 (1))

  – shall ensure that the register accurately reflects the legal situation at all times (Section 7 (2)); according to Section 7 (2) sentence 2, the registrar is obliged to compensate the damage caused by improper keeping of the register

  – assumes a guarantee liability towards the participants for the guarantee of data protection, data security and data integrity (Section 7 (3) sentence 1)

- Issuer of crypto securities

  – Obligations to select and monitor pursuant to Section 21 (1) (statutory guarantor position)

  – Own negligence (Section 278 BGB) or guarantee liability on non-fault basis

Governing Law

- Law governing the object, i.e. the security as a thing (*Wertpapiersachstatut*)
  - Rights in and transfer of ownership in an electronic security shall be governed by the law of the state under whose supervision the entity keeping the register is (Section 32)
  - Provision in the eWpG only concerns the law governing the security as a thing as special provision in the are of conflict-of-laws rules; delimitation to
    - Rome-I-Regulation: not applicable to tradable securities
    - EU Settlement Finality Directive : Delimitation to Section 17a DepotG
- Law governing the creation of and rights from the security (*Wertpapierrechtsstatut*)
  - Determines whether an instrument can be issued as a security
  - Where an instrument is governed by German law, German law may determine the question of form (Section 2)
  - If an instrument is governed by foreign law, the latter shall decide on the questions of form
  - Consequently, the regulation of the form contained in Section 2 presupposes the applicability of German law with regard to the form, which is why it can be concluded that only bearer dept securities governed by German law can fall within the scope of the eWpG (tbd, whether this also applies to securities that have a so-called "split-law" clause)

Amendment of further German laws

Amendment of the DepotG

- Section 1 sentence 3: Inclusion of electronic securities (insofar as held in custody within the meaning of the DepotG)

- Section 6 (2) (relevant for all securities in collective entry according to Section 9a and Section 9b DepotG)

  – Right to issue a certificate of deposit (*Depotbescheinigung*) for the purpose of exercising rights (sentence 1)

  – Obligation of the custodian with regard to accuracy with protective effect for the benefit of third parties (sentence 2)

  – Legal fiction of holder for the purpose of providing evidence (sentence 3)

  – Clarification that processing and settlement by way of collective holdings is decisive (sentence 4)

- Section 9b DeptoG: In parallel to Section 9a DepotG (which applies to (physical) debt securities in form of global notes), Section 9b DepotG stipulates the applicability of the provisions on collective custoday to electronic securities in collective custody

Amendment of the German Prospectus Act

- Pursuant to Section 4 (3a) of the German Securities Prospectus Act (*WpPG*) (new), the catalogue of minimum disclosures in a securities information sheet for electronic securities is extended by the following disclosures:

  – the technical design of the security, the technologies underlying the security and the transferability and tradability of the security on the financial markets

  – registrar within the meaning of the eWpG and an indication of where and how the investor can inspect the register

- The aim of the extended disclosure is to ensure greater transparency for potential investors and to increase investor protection overall

- In this case, the information sheet may comprise up to 4 A4 pages

- Since the regulatory concept of securities used in the WpPG is broader than the concept of securities under German civil law (to which the eWpG is linked) the supplementary regulations also apply to so-called security tokens that are neither securitised nor constitute electronic securities within the meaning of the eWpG

Amendment of the German Banking Act (KWG)

Administration of crypto securities registers

- Acting as registrar does not qualify as custody activity

- Acting as registrar qualifies as a financial service pursuant to Section 1 (1a) No 8 (new) (purpose: investor protection, market integrity as well as transaction security)

- Administrators are supervised by BaFin (Section 11 eWpG) and are, inter alia, subject to requirements, such as a minimum initial capital of TEUR 125 (Section 33 (1) sentence 1 no. 1 b) KWG), organisational obligations and reporting requirements applicable to financial institutions

- Registars are to be regarded as obliged entities within the meaning of Section 2 (1) of the Money Laundering Act and are subject to requirements in Sections 25h and 25k (KWG)

Custody of crypto securities

- The custody of crypto securities falls under the definition of a custody business, and it is not a crypto custody business within the meaning of Section 1 (1a) sentence 2 no. 6 (new)

- The extension of the definition of a crypto custody business refers only to the safeguarding of cryptographic keys (note the transitional provision in Section 65)

- If, within the scope of the custody business with crypto securities, associated cryptographic keys are also secured, no permission for the separate securing of these cryptographic keys shall be required in addition to the permission for the custody business.

Transitional provisions and amendment of Section 65 KWG

- A company that already has obtained permission to conduct the crypto custody business may also operate this business with respect to the custody, management and security of private cryptographic keys related to <u>crypto securities</u>

- Deemed permission for the administration of a crypto securities register for companies that take up an activity pursuant to Section 1 (1a) sentence 2 no 8 KWG (new) within six months of the entry into force of the eWpG, if

  – the company submits a complete application for permission in accordance with Section 32 (1) sentences 1 and 2 KWG, also in conjunction with an ordinance in accordance with Section 23 eWpG, not later than six months after commencing its activities, and

  – if it notifies BaFin in writing of its intention to commence operations two months before commencing operations

  – Although Section 64y KWG may be seen as role model, crypto custody business cannot be the starting point for a deemed permission, as electronic securities are only created when the eWpG comes entry into force

Definition of "Financial Instrument" and Regulation on Markets in Crypto-assets (MiCA)

MiFID II Framework vs MiCA

As part of its Digital Finance Package, the EU Commission has proposed an Amending Regulation which amends the definition of "financial instrument" under MiFID II to include instruments issued by means of distributed ledger technology (DLT)

MiFID II Financial Instruments

- Transferable securities (equity and debt instruments)
- Money market instruments
- Units in collective investment schemes
- Derivatives (options, futures, swaps etc.)
- Contracts for differences (CFDs)
- Emission allowances

eWpG

- Bonds
- Covered bonds
- Certificates
- Units in investment funds

MiCA Framework

- Crypto-assets that **do not qualify** as financial instruments, deposits, structured deposits, securitisations or e-money under applicable EU legislation

| Asset-referenced tokens | E-money tokens | Other crypto-assets |

Scope of MiCA

- Single EU regulatory framework for those crypto-assets which do not already qualify as financial instruments, deposits, structured deposits, securitizations or e-money under relevant EU legislation (MiFID II, CRR, EMD etc.)

- Affects all crypto-assets (ie. digital representation of value or rights, which may be transferred and stored electronically, using distributed ledger or similar technology)

| **Issuers of crypto-assets** | **Anyone offering crypto-assets** | **Crypto-asset service providers and crypto markets** |

- A mandatory regime which aims to provide a clear legal framework, support innovation, consumer and investor protection, market integrity, financial stability

Taxonomy of crypto-assets under MiCA

Asset-referenced tokens

- Cryptoassets that purport to maintain a stable value by being linked to the value of several fiat currencies, one or several commodities, cryptoassets, or a basket of such assets.

E-money tokens

- 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.

Other crypto-assets

- Catch-all category which aims to capture all types of cryptoassets that do not fall under the definition of either asset-referenced or e-money token (including virtual currencies).

- Utility tokens that are defined under MiCA as cryptoassets that are intended to provide digital access to a good or service, available on DLT, and that are only accepted by the issuer of such tokens also belong to this category.
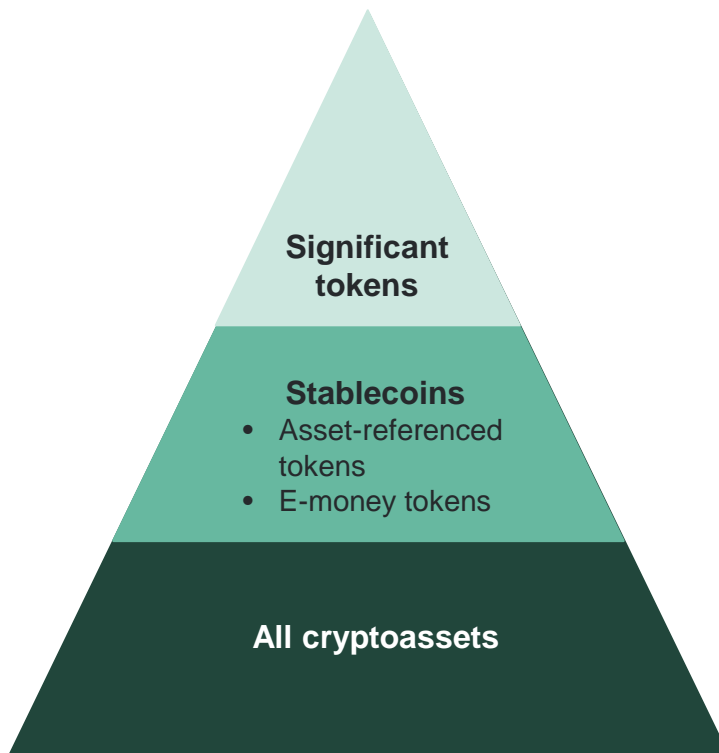
MiCA Framework

| |
| Asset-referenced tokens |
| E-money tokens |
| Utility tokens |
| Virtual currencies (BitCoin, Ether) |

E-money (EMD)

Security Tokens that qualify as Financial Instruments (MiFID II)
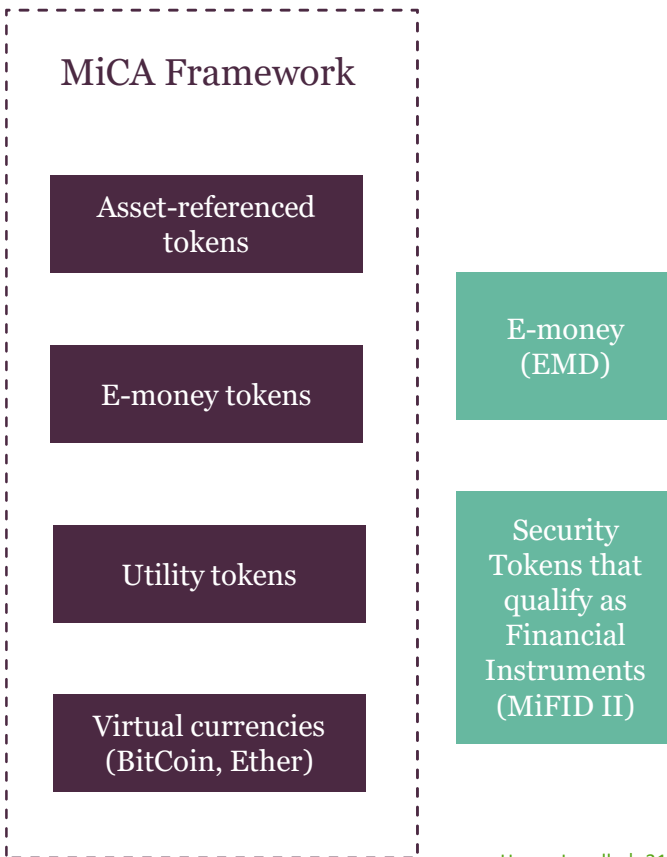
Requirements on issuers: categories of cryptoassets

Additional requirements

Significant tokens

Stablecoins
- Asset-referenced tokens
- E-money tokens

All cryptoassets

Base requirements

Cryptoasset issuers: Overarching requirements

All cryptoassets	Stablecoins		Significant tokens
	Asset-referenced tokens	**E-money tokens**	
• Must publish a **whitepaper** which is **notified** to the national competent authority **20 days** prior to publication • Must a **legal entity**	• Authorised with relevant NCA • Must be a legal entity established in the EU • Whitepaper must be **pre-approved** as part of the authorisation process • Clear policy for **stabilisation mechanism** • Rules on **custody** and **investment** of reserve assets • Ongoing **information obligations** beyond the whitepaper	• Authorised as a **credit institution** or **an e-money institution** • Must publish a **whitepaper** which is **notified** to the national competent authority **20 days** prior to publication • Immediately redeemable **at par** • Restrictions on **investment** of funds received for e-money tokens	• More onerous requirements (e.g. **capital** and **liquidity** requirements) • EBA supervision

Issuance requirements

Whitepaper: content requirements		
All cryptoassets	**Additional content requirements for stablecoins**	
	Asset-referenced tokens	E-money tokens
• information about the issuer • detailed description of the offer, crypto-assets and project to be carried out with the capital raised • information about the rights and obligations attached to cryptoassets • the underlying technology • risks associated with crypto-assets • statement confirming compliance • disclaimer that the white paper is not yet approved • disclosure items specified in Annex I	• information on the stabilisation mechanism • investment policy of the reserve assets • issuer's governance arrangements • custody arrangements for the reserve assets • the rights provided to holders • clear warning if no direct claim or redemption right on reserve assets • disclosure items specified in Annexes I and II	• explicitly indicate that holders of e-money tokens have a right to redeem their e-money tokens against fiat currency at par value and at any moment • procedures and conditions of redemption • disclosure items specified in Annex III

Other requirements relating to offerings

- **Marketing documentation** must be fair, clear, non-misleading and consistent with information presented in the white paper.

- Any exclusion of **civil liability** in the white paper or marketing documentation will automatically be deprived of any legal effect.

- Investors who purchased cryptoassets (other than asset-referenced or e-money tokens) directly from the issuer has a **right to withdraw within 14 days** (but not where cryptoassets were admitted to trading on trading platform for cryptoassets).

Exemption from whitepaper requirements (except for issuers of asset-referenced or e-money tokens)

- Cryptoassets are offered for free

- Cryptoassets are automatically rewarded in the course of mining

- The total consideration for the offering < EUR 1 million (over 12 month period)

- The offering is limited to qualified investors or to less than 150 investors per EU Member State

- Cryptoassets are unique and not fungible with other cryptoassets

Cryptoasset service providers: key requirements

Cryptoasset services include:

- Custody and Administration

- Trading platforms

- Exchanges (crypto-fiat / crypto-crypto)

- Execution of orders in cryptoassets on behalf of third parties placing cryptoassets

- Reception and transmission of orders for cryptoassets on behalf of third parties

- Provision of advice

Basic requirements	Entities providing **cryptoasset services** must be **authorised** and be a **registered legal entity in the EU**
Conditions of authorisation	Must demonstrate: • Sufficient capital to meet prudential requirements • Effective governance and internal control • Act in client's best interest • Systems in place to prevent market abuse
Other requirements	Other requirements apply depending on type of service provider, for example: • Custodians must **segregate holdings** • Exchanges must **publish prices** and have **non-discriminatory policy** regarding accepted clients • Trading platforms will need to establish operating rules such as **minimum due diligence** and **approval processes** for admittance of cryptoassets

Legal Considerations

	Positive	Negative
Industry	• Regulation on EU level is welcome—this overrides national regimes and makes application of the law more straight forward • MiCA introduces a set of definitions which are likely to become widely adopted outside of the EU • Technical standards have been deferred to the ESAs as opposed to prescribed in main text	• Lengthy process of ESA oversight leads to authorisation delays • MiCA is ultimately a subsidiary piece of legislation—there is still a need to analyse whether financial services legislation applies • No harmonised definition of "financial instrument"

Level Playing Field

Credit Institutions and Investment Firms are exempt from having to comply with aspects of this regulation

Scope of Article 2 (4), (5) and (6)

4. Where issuing asset-referenced tokens, including significant asset-referenced tokens, **credit institutions authorised under Directive 2013/36/EU shall not be subject to**:

(a) the provisions of chapter I of Title III, except Articles 21 and 22;

(b) Article 31.

5. Where providing one or more crypto-asset services, **credit institutions authorised under Directive 2013/36/EU shall not be subject to** the provisions of chapter I of Title V, except Articles 57 and 58.

6. **Investment firms authorised under Directive 2014/65/EU shall not be subject to** the provisions of chapter I of Title V, except Articles 57, 58, 60 and 61, where they only provide one or several crypto-asset services equivalent to the investment services and activities for which they are authorised under Directive 2014/65/EU.

Tech Neutrality/Proportionality

- Current drafting suggests that certain utility tokens would be caught under MiCA when their equivalent non-financial activity would fall outside of scope

- Article 4(2)(e) and Article 15 (3) both suggest that this regulation should apply to all activity over €1m, which is out of step from the direction of travel in the Prospectus Regulation and the Crowdfunding Service Providers Regulation

- Article 31 requires entities to hold 2% of own funds, which will be onerous for entities seeking small raises
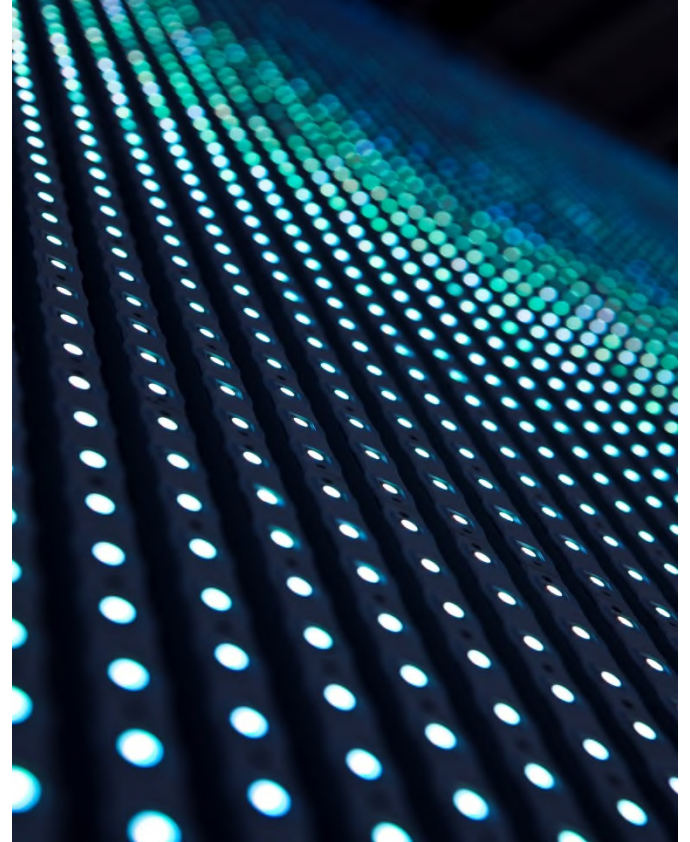
Pilot regime on DLT financial market infrastructures

Pilot Regime for DLT based market infrastructures

Proposed Regulation creates EU-wide regulatory sandbox regime which aims to take away elements under the current regulatory framework which are incompatible with the implementation of Blockchain and Distributed Ledger Technology ('DLT') in financial market infrastructures.

National Competent authorities (NCAs) will be able to grant specific exemptions from existing legislative provisions which currently restrict market infrastructures from deploying DLT.

DLT market infrastructure	Key points
- DLT multilateral trading facility (or DLT MTF) which is a "multilateral trading facility, operated by an investment firm or a market operator, that only admits to trading <u>DLT transferable securities</u> - DLT securities settlement system which is a "securities settlement system, operated by a central securities depository (CSD), that settles transactions in <u>DLT transferable securities</u> against payment"	- Only authorised investment firms, market operators and CSDs can apply for permission to operate a DLT MTF or DLT SSS - DLT MTFs can be exempt from recording trading of DLT transferable securities with a CSD and from intermediation requirements. - DLT SSSs can be exempt from cash settlement requirements and can therefore settle in token form

Requirements for DLT MTFs and DLT SSSs

Securities requirements

- Eligible "DLT Transferable Securities":

  o Shares, the issuer of which has a [tentative] market capitalisation of **less than EUR 200 million**

  o Convertible bonds, covered bonds, corporate bonds, other public bonds and other bonds, with an issuance size of **less than EUR 500 million**

- **Sovereign bonds cannot be traded or recorded.**

- Total market value of DLT Transferable Securities cannot exceed **EUR 2.5 billion.**

Other requirements

- **Specific conditions attached to each exemption** and any **additional requirements** imposed by NCAs

- General requirements relating to:

  o Business plan

  o Documented rules detailing how the DLT market infrastructure operates

  o IT and cyber arrangements

  o Integrity, security and confidentiality of data

  o Exit strategy

  o Safekeeping arrangements

  o Risk management, access to the infrastructure, the participation of validating nodes, conflicts of interest

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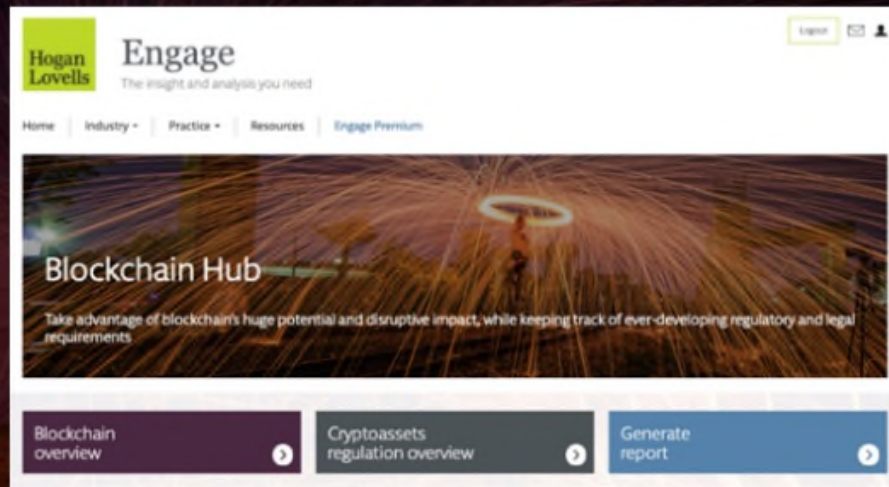
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Questions & Answers

Your contacts at Hogan Lovells

Dr. Jochen Seitz
Partner, Frankfurt
+49 69 96 23 6700
jochen.seitz@hoganlovells.com

John Salmon
Partner, London
+44 20 7296 5071
john.salmon@hoganlovells.com

Brusch Markus LL.M.Eur.
Counsel, Frankfurt
+49 69 96 23 60
markus.brusch@hoganlovells.com

www.hoganlovells.com