



**DIGITAL CURRENCIES**  
Governance Group

# DLT PILOT REGIME

DCGG Position Paper

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The Digital Currencies Governance Group (DCGG) supports **the Commission’s proposal on a pilot regime for market infrastructures based on distributed ledger technology (DLT)**. The idea of a regulatory sandbox geared towards developing innovative uses and technologies via DLT is **a crucial component of the crypto-assets regulatory ecosystem that is currently being created in the EU**. DCGG supports DLT and new solutions based on it as it allows for a number of efficiencies, including reducing the compromise of financial data that is currently mostly kept in central systems that are more susceptible to cyber-attacks. DLT also allows leveraging zero-knowledge proof (ZKP) technology, which allows data analysis without de-facto data transfer, safeguarding privacy and improving cybersecurity. DLT also offers greater transparency of transactions and information which not only helps in mitigating financial stability risks but also promotes users’ trust. DCGG sees that DLT has great potential to help revolutionise the financial sector and market infrastructures and therefore supports the Commission’s efforts to create a controlled environment for the safe experimentation with DLT.

## **ISSUE #I: USE THE PILOT REGIME TO ENABLE A WIDER APPLICATION OF DLT IN FINANCIAL SERVICES**

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- DCGG feels that the scope of the Pilot Regime Proposal is too narrow and that there are more areas that it could expand on.
- The current proposal only allows for a regulatory sandbox for authorised market participants to operate either a DLT Multilateral Trading Facility (MTF) and a DLT Securities Settlement System (SSS).
- The European Parliament’s proposal does include a third category for DLT Trade and Settlement System (TSS), but there are more areas, beyond market infrastructure, that could be explored through this Regulation:
  - If the Pilot Regime is expanded to wider variety of DLT use cases, the financial services industry can accumulate more know-how on novel DLT techniques, which can be widely applicable, like ZKP.
  - The Pilot Regime should consider testing DLT solutions in relation to compliance and systems operations (i.e. allow RegTech access to the sandbox.) These tests usually happen through collaborations between authorised financial service providers and technology providers of RegTech solutions. Thus, the Pilot Regime should be open to collaborative applications.

Given the potential impact of crypto-asset issuance on capital markets, as well as payments, the pace at which these products evolve, and the novelties around them, the Pilot Regime could also be a way for regulators to test new tokens in a limited, controlled way.

## Solution:

- Expand the scope of the Pilot Regime to give access to ART and EMT issuers interested in developing unique and innovative solutions for DLT-based market infrastructure.
- Expand the scope of the Pilot Regime to allow access to authorised firms testing DLT tech to use it for compliance (RegTech) and set out guidelines on cooperation with other market participants and third-party technology vendors.

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## ISSUE #2: STRUCTURE ACCESS TO PILOT REGIME TO FIRMS SEEKING AUTHORISATION, ALLOWING THAT THE REGIME IS USED FOR LEARNING

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- DCGG is concerned that the Pilot Regime requires that applicants already are authorised as MTFs or CSDs.
- In this way, the Pilot Regime is set up against the logic of most existing Regulatory Sandboxes around the world, which have track records demonstrating that SMEs use Pilot Regimes far more often than incumbents in order to test a new model and, together with regulators, ensure it is safe for consumers. Requirements to obtain full authorisation is usually leveraged when exiting the Sandbox, not when entering it.
- The proposal, as it stands, favors incumbent market participants to leverage the regulatory sandbox more effectively than smaller or new firms seeking to become market participants to develop their own DLT-based solution.
- The proposal does not completely address certain regulatory obstacles for new firms seeking market entry, which stem from the regulatory uncertainty of using new technologies. Not addressing such obstacles usually results in technologies not being adopted.
- It is important to note that this topic must be approached carefully in order to avoid any potential abuse of exemptions. This can be done through consumer protection rules in the Pilot Regime.

## Solution:

- The Pilot Regime should be amended to allow firms seeking to be authorised as market participants to benefit from the regulatory sandbox while they are pending the appropriate authorisations.
- This will allow for a smoother transition for smaller firms to work on securing the appropriate authorisation, while being able to start the initial phases of their testing, giving the firm, its investors and its supervisors confidence that the new business has product-market fit as well as leaves consumers better off, before its fully rolled out on the market