5th Distributed Ledger Technology Workshop

Day 2, Session 7

Analysis of the Impact of European Policy on Distributed Ledger Technologies and Crypto-assets

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Technological Perspective

- On-chain Rules
- **Off-chain Rules**

Endogenous off-chain rules such as the **social norms of blockchain developers**

Exogenous off-chain rules such as **law and regulation**

Legal Policy Perspective

- Self-regulation
- **Public Regulation**

Data Privacy Cyber Security

Anti-money Laundering

Financial Regulation

Taxation

RISKS

- **Uncertainty for legal responsibilities**
  E.g. the burden of the risks of attacks from the affected parties
- **Discretion on the security measures of the distributed networks**
  E.g. technical resilience
- **Unregulated centralization in some domains**
  E.g. electronic money token issuers
- **Legal Uncertainty**
  "Timidity" of institutions

NEED FOR REGULATION

- **Solutions for the issues that cannot be achieved with endogenous attempts**
  E.g. enforced legal obligation for periodical network stress tests to have more unvulnerable infrastructure
  E.g. compensation of financial losses for counter-parties in crypto-asset markets
- **Prevention of illicit activities that benefit from permissionless nature of the infrastructure**

HARDSHIP OF REGULATION

- Permissionless nature of public ledger networks
- Operational autonomy of network participants
- Easy legal arbitrage

BENEFITS OF REGULATION

- Mandatory and tight audits
- Legal certainty
- Legal protection against misinformation
- Promoting innovation

European Approach

- Agnostic for different infrastructures
- Allowing stakeholders to participate the proceeding
- Promote the integration of DLT solutions to the current system and infrastructure
- Sensitive on privacy

The GDPR, The NIS and NIS2 Directives, The MiFID and MiFID2, the Market Abuse Regulation

The European Digital Finance Strategy Package

DORA

MiCA

Pilot Regime

Amedment

The U.S.A.

- **No legal clarification**
- **Doesn't allow the integration**

China

- **Heavy restriction**
- **Doesn't allow the integration**

Digital Operational Resilience

- Risk management
- Monitoring critical systems
- Ensuring robust operations for financial institutions
- Recover from cyber-attacks

Common set of requirements

Management of risks related to ICT

Reporting system to the ESA

Stress tests

Legal enforcement

Regulation on Markets in Crypto-assets

- Legal taxonomy for crypto-assets
- Certain rules for CASPs
- Informational requirements for marketing
- Governance arrangements
- Strict regulation over electronic money tokens

All crypto-assets except security tokens

Electronic money tokens, asset referenced tokens, utility tokens

The ESMA becomes the main regulator authority

Extended international cooperation

The Pilot Regime

- A framework for testing DLT-based market infrastructures
- Encourage innovation in financial sector
- Easy regulatory oversight

Sunset clause for testing period

Exception for certain regulatory requirements only for testing

Opportunity to integrate or migrate traditional data-keeping systems to DLT

Data provision to regulators

Important questions that await the ESAs, the EC and the ECJ to respond:

1) What kind of sustainability mechanisms will be applied to proof-of-work consensus mechanism?
2) How will be "non-fungible tokens" or digital collectibles treated?
3) What will be the explanation of "decentralized protocol" in terms of law?
4) How will be the mutation in the characteristics of a crypto-asset treated?

The Impact of the European Policy and Regulation

Economic Impact	Cyber-security	Public Offerings	Electronic Money Tokens	Decentralized Finance
• The double burden on the ESMA • Positive economic benefits for the future of the markets	• Audits for vulnerable points of DLT networks • Early detection	• Obligation and enforcement for initial coin offerings • Most of the crypto-assets will be classified as utility tokens	• Strict regulation for e-money token issuers • Algorithmic "stable" coins are out of the scope	• Exception for "purely" decentralized models • Still uncertain • Significant impact on DAOs • Impact on "liquid staking" protocols

OVERALL

NEGATIVE IMPACTS

- Restriction on proof-of-work
- Disruption in DAO treasuries

POSITIVE IMPACTS

- Mandatory cyber safeguards
- Legal certainty for CASPs and crypto-asset issues
- Innovation to traditional systems through the pilot regime

UNCERTAINTY

- The description of "purely decentralized" models
- The policy towards "NFTs"
- Legal treatment in a case of change in the characteristics of a crypto-asset

Lastly: The implementation of the related administrative authorities and the European case law regarding DLT based products will be as important as the current policy and the regulation of the European Union.

Thank you for your attention.