

# DLT Pilot Regime and Blockchain III Law

## INCREASED LEGAL CERTAINTY AT EUROPEAN AND LUXEMBOURG LEVELS TO ENABLE THE INTERNATIONAL CAPITAL MARKETS TO BENEFIT FROM NEW TECHNOLOGIES

### Executive Summary

- Both the EU and the Luxembourg legislators have recently adopted new rules to promote innovation and the use of distributed ledger technologies in the financial sector.
- A new pilot regime has been created on a European level to allow the development of DLT market infrastructures. The EU DLT Pilot Regime will be fully applicable from 23 March 2023.
- The Luxembourg Parliament has approved a new law transposing the EU DLT Pilot Regime into national law and recognising the possibility of using DLT instruments for financial collateral arrangements. The law was published in the official journal on 17 March 2023 and will enter into force on 23 March 2023.

The potential applications of distributed ledger technology (“DLT”) has evolved substantially in the last decade, and the use cases now vary from non-fungible tokens created by well-known artists, to digital bonds issued by issuers such as the European Investment Bank, that can be listed on the securities official list of the Luxembourg Stock Exchange. To promote the application of innovative technologies in the financial sector, while still preserving investor protection, market integrity and transparency, new rules relating to the use of DLT have recently been adopted both at European and Luxembourg levels.

These amendments are another step towards the modernisation of the financial sector legislation, in particular

<sup>1</sup> DLT multilateral trading facilities, DLT settlement systems or DLT trading and settlement systems, as defined in Article 2(5) of Regulation (EU) 2022/858.

with respect to the efficiency and transparency of the international capital markets.

This GSK Update briefly outlines the main changes introduced by the Regulation (EU) 2022/858 (the “**EU DLT Pilot Regime**”) and the Luxembourg law of 15 March 2023 (the “**Blockchain III Law**”), which supplements the EU DLT Pilot Regime in Luxembourg and addresses a few points left open by the previous laws on DLT.

### I. The EU DLT Pilot Regime

The EU DLT Pilot Regime was introduced by the European Commission in September 2020, as part of its Digital Finance Package. Among others, the package introduced two regulations relating to crypto assets, a dedicated new regulatory framework for markets in crypto assets (“**MiCA**”), and a separate pilot regime for crypto assets that qualify as financial instruments under the Directive 2014/65/EU on markets in financial instruments (“**MiFID II**”). The use of such DLT financial instruments was, on the one hand, constrained by the existing financial services legislation, and at the same time considered to be subject to new risks raised by the underlying technology. The EU DLT Pilot Regime, that aims to address these risks, will be fully applicable from 23 March 2023.

### A New Regulatory Sandbox

The new regime provides a regulatory sandbox that allows the competent national authorities to temporarily exempt DLT market infrastructures<sup>1</sup> from certain specific requirements imposed by existing legislation on traditional market infrastructures. The aim of the EU DLT Pilot Regime is to ensure that the existing requirements do not



prevent operators of DLT infrastructure from developing solutions for the trading and settlement of transactions in crypto assets that are treated as financial instruments, without weakening the existing requirements and safeguards applying to traditional market infrastructures.

### Entities and Instruments in Scope of the New Regime

To benefit from the new pilot regime, entities applying for the exemption must fulfil certain criteria set out in the regulation, namely be an authorized financial institution (e.g. an investment firm, market operator or a central securities depository). Such entities are required to apply for a specific permission, which may be granted on a temporary basis for a period of up to six years.

Moreover, the types of DLT instruments covered by the pilot regime are limited to shares, bonds and units in collective investment undertakings, and the aggregate market value of such instruments is limited in order to avoid risks to financial stability.

## II. The Luxembourg Blockchain III Law

The Blockchain III Law follows in the footsteps of previous initiatives taken by the Luxembourg legislator. After the adoption of the law of 1 March 2019 (the “**Blockchain I Law**”) and the law of 22 January 2021 (the “**Blockchain II Law**”), the Luxembourg legal framework already explicitly recognises the possibility to use DLT for the issuance and circulation of securities.<sup>2</sup>

All of the blockchain laws, including the latest addition, aim to ensure a principle of technological neutrality. In addition to implementing the EU DLT Pilot Regime, the new Blockchain III Law explicitly recognises the use of DLT instruments for financial collateral arrangements.

### Implementation of the EU DLT Pilot Regime: Legal certainty for the classification of DLT financial instruments

One of the clarifications introduced by the EU DLT Pilot Regime is the amendment of the term “*financial*

*instruments*” under MiFID II, which has been extended to explicitly cover also financial instruments issued by means of distributed ledger technology.

The Blockchain III Law transposes this change into Luxembourg law by amending the law of 5 April 1993 on the financial sector and the law of 30 May 2018 on markets in financial instruments. For the purposes of both laws, the term financial instruments will now specifically include instruments which are issued using DLT (*technologie des registres distribués*) within the meaning of Article 2(1) of the EU DLT Pilot Regime.

Despite the technical nature of these amendments, their importance for the financial sector should not be underestimated, as the new framework provides increased legal certainty for issuer of security tokens and other market participants.

### Amendment of the Luxembourg Financial Collateral Law: Use of DLT Securities as Collateral

The Blockchain III Law also increases legal certainty for the use of securities registered using distributed ledger technologies as collateral, by amending the definition of financial instruments under the Law of 5 August 2005 on financial collateral arrangements (the “**Financial Collateral Law**”). The amendment clarifies that the financial instruments that may be used as collateral under the Financial Collateral Law include also book-entry instruments that are registered or existing in securities accounts maintained in or through secure electronic recording devices, including distributed electronic registers or databases.

This targeted modification of the Financial Collateral Law follows the amendments introduced by the Blockchain I Law, which introduced a new Article 18*bis* to the law of 1 August 2001 on the circulation of securities. The second paragraph of this new Article confirmed that the validity or effectiveness of the collateral set up in accordance with the Financial Collateral Law are not affected by the maintaining of securities accounts within a secured electronic registration mechanism, including distributed electronic

<sup>2</sup> On the previous amendments, see the GSK Updates “[Luxembourg passes law allowing the use of blockchain in the issuance](#)

[and circulation of securities](#)” and “[Blockchain II Law: Another step forward for the digitalization of EU capital markets](#)”.



ledges or databases, or by the credit of securities on securities accounts through such a secured electronic registration mechanism.

Following these amendments, parties can now be assured that the validity and perfection of a security interest created under the Financial Collateral Law will not be affected by the technical means in which the pledged security is created or held.

### III. Next Steps for the Digitalisation of the European Financial Sector

After several years of debate over the legal classifications of different types of assets and infrastructures based on DLT, the recent regulatory developments provide the financial markets with a specific legal framework to profit from the use of new innovative technologies in full legal certainty. However, both the EU DLT Pilot Regime and the Blockchain III Law are targeted regimes with a specific scope of application of DLT, and further changes are still expected to be adopted on a European level based on the lessons learned from the EU DLT Pilot Regime. The European Securities and Markets Authority (ESMA) is mandated to present a report to the European Commission by March 2026 containing its assessment of the pilot regime, that will be used as a basis for possible regulatory changes to be proposed by the European Commission.

Furthermore, additional regulatory changes relating to crypto assets that do not qualify as financial instruments are also expected to be adopted shortly by the European legislators. Once approved, the new MiCA regulation will introduce specific regulatory requirements tailored for the markets in crypto assets such as asset-referenced tokens and utility tokens.

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