

THE EUROPEAN DIGITAL FINANCE PACKAGE

A MUST READ FOR ANY PERSON ACTIVE IN THE FINTECH INDUSTRY

The ongoing COVID-19 pandemic shows the importance of digitization of financial services. The digital transformation is stimulated by several initiatives taken by the European Commission. On 24 September 2020 the European Commission published the [Digital Finance Package](#) consisting of a [Digital Finance Strategy](#), a [Retail Payments Strategy](#), legislative proposals for an EU regulatory framework on [markets in crypto-assets](#) and on [a pilot for market infrastructures based on distributed ledger technology](#), and a proposal for an EU regulatory framework on [digital operational resilience](#).

Naturally you can spend your Christmas holidays (whether in lock down or not) by reading this very important set of documents published by the Commission. But if your family does like you to have some quality time with you, you may wish to limit it to reading this blog for now. The uptake is clear: FinTech is hot. Prepare yourself for a big regulatory and legal challenge to come! If you do not prefer to take on that challenge alone, we are ready to assist you!

DIGITAL FINANCE STRATEGY

In its Digital Finance Strategy, the European Commission lists the **four priorities** with the aim of further stimulating the digital transformation. Up to 2024, it will focus on

- tackling fragmentation in the Digital Single Market for financial services;
- ensuring that the European regulatory framework facilitates digital innovation;
- creating a European financial data space to promote data-driven innovation; and
- addressing new challenges and risks resulting from the digital transformation.

The aim is to create an integrated, cross border and open market for transfer of funds within the European Economic Area. For example, the Commission will give substance to the first priority by implementing a European legal framework enabling customers to use an EU-wide interoperable digital identity for onboarding (AML/CFT) purposes and by introducing passporting possibilities in the regulatory framework applicable in all key areas that are relevant to digital finance. The recently published [Crowdfunding Regulation](#) and the draft regulation on markets in crypto-assets both provide for passporting rights.

These EU priorities are shared by the Dutch Minister of Finance. In its [preliminary response](#) to the Digital Finance Package, the Standing Committee of Finance within the Dutch House of Representatives generally endorses the initiatives taken by the European Commission. In particular the Dutch government welcomes an EU-wide interoperable digital identity and the intentions to further investigate the possibilities to introduce central bank digital currencies. We will elaborate in a bit more detail in the relevant paragraphs below.

These European initiatives are in line with the [Dutch FinTech Action Plan](#) which was published in July 2020. In the Dutch FinTech Action plan, three pillars are proposed to stimulate innovation in the Dutch financial sector and to enable Dutch FinTech companies to flourish. These pillars are: (i) putting the Dutch FinTech climate and the Dutch FinTech industry on the map, both nationally and internationally, (ii) creating easy access to knowledge and talent for FinTech companies, and (iii) having in place future proof legislation and regulations that facilitate innovation. Within each pillar, a number of contemplated actions are proposed, both on a European, an intentional and a national level. The actions on a national level include, for example, the offering of guaranteed SME loans, developing residency arrangements for foreign key personnel of start-ups and making it more attractive to grant stock options as part of salaries from a Dutch tax perspective. The national actions proposed in the FinTech Action Plan also aim to ensure that FinTech companies have easy access to material information in respect of the regulatory framework applicable to them and to keep in mind how this regulatory framework, as well as the costs involved with regulatory oversight, can be applied in a more proportionate manner to small companies and start-ups. Lastly, the national actions would aim at strengthening the existing initiatives of the Dutch financial regulators such as the InnovationHub, 'Regulatory Sandbox' and iForum.

RETAIL PAYMENTS STRATEGY

Whilst the dust of PSD2 is still settling, in particular when it comes to the standardization and implementation of strong customer authentication requirements, the European Commission already announces further amendments to come as part of the recently published [Retail Payments Strategy](#).

Part of that strategy is to adopt a legal framework which would enable the use of **interoperable digital identity solutions** such as an eID to satisfy the strong customer authentication requirements.

One of the four pillars in the Retail Payments Strategy focuses on the publication of a new proposal for an **open finance** (rather than mere open banking) eco-system by mid-2022. The review of PSD2 (expected by the end of 2021) will likely include a proposal to merge EMD2 into PSD2 by introducing the issuance of e-money as a new payment services under PSD2 (or PSD3). It will also examine whether technical service providers that provide ancillary services to actors in the payments chain should be subjected to regulatory supervision as well. These technical service providers are currently still exempt from oversight pursuant to PSD2.

Another pillar focuses on the full **uptake of instant payments** by the end of 2021, potentially by requiring payment service providers to adhere to the scheme for instant payments as developed by the European Payment Council by the end of 2021. While emphasizing the importance of maintaining the availability of cash money, the European Commission does research the possibilities of issuing a retail central bank digital currency (CBDC) as well.

A third pillar aims at facilitating an **open and accessible payments ecosystem**. The European Commission will look into an extension of the scope of the Settlement Finality Directive to include e-money institutions and payment institutions enabling these financial undertakings to get access to, for example, the TARGET2 payment system directly, rather than the current indirect access via credit institutions or central banks.

Lastly, the European Commission will look into the possibilities of improving the speed, costs, availability, transparency and convenience of cross border payments to or from a non-member state of the EU. In the key actions formulated by the Commission, it strikes us that no mentioning is made of the possibility to use (then) regulated forms of stable coins or central bank digital currencies for cross border payments and remittances involving a payer or beneficiary outside the EU.

The **Dutch government** endorses the Retail Payments Strategy of the European Commission. On a national level, there are already several regulations to ensure that each Dutch resident has good access to the payment infrastructure such as a maximum distance to an ATM and detailed rules applicable to the larger payment service providers to ensure a proper functioning of cashless payments. Also instant payments is already well implemented in the Netherlands. One of the objectives of the Dutch government - introduction of **account number portability** enabling account holders to easily transfer to another bank (or other payment service provider) - is not taken into account in the Retail Payments Strategy. For the Dutch government other important factors that should be considered when developing a more open finance European ecosystem are data protection and consumer protection, in particular in respect of consumers' payment data and taking into account the increasing influence of BigTechs.

DRAFT REGULATION ON MARKETS IN CRYPTO-ASSETS

Crypto assets are digital representations of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology. Since this year crypto service providers offering either exchange services between fiat currencies and crypto currencies or by offering custodial wallets fall under integrity supervision pursuant to the Fifth Anti-Money Laundering Directive as implemented in the national laws of each of the member states. Other than the registration obligation for such crypto service providers under this piece of legislation, the regulatory framework applicable to crypto assets and service providers in respect of those assets is not harmonized. But more and more supervisory authorities seem to have consensus that security tokens should be treated as securities, resulting in for example the MiFID II framework, the Prospectus Regulation and the Market Abuse Regulation to (potentially) kick in. However, legal uncertainty remains to be omnipresent. This uncertainty may be history soon. As part of the Digital Finance Package, the Commission published a draft proposal for a [regulation on Markets in Crypto-assets \(MiCA\)](#). MiCA provides for a regulatory framework applicable to issuers of crypto assets and crypto service providers who fall out of scope of the current regulatory framework.

MiCA pursues the following four objectives:

- legal certainty within the EU;
- stimulate innovation;
- organizing consumer protection and preventing market abuse; and
- safeguarding financial stability.

Three sub-categories of crypto-assets are distinguished in the draft Regulation and fall within the scope of MiCA:

- **utility tokens;**

and two types of stable coins:

- **asset-referenced tokens** with a payment functionality which aim at maintaining a stable value by referencing a specific asset; and
- **e-money tokens** with a payment functionality which aim at stabilizing their value by referencing a single fiat currency.

The MiCA framework is clearly derived from existing regulations. An issuer is required to publish a **white paper** which also needs to be provided to the regulator. On the basis of the whitepaper, the regulator should determine whether the crypto assets contemplated to be offered fall under the scope of MiCA or under the scope of the currently already existing regulatory framework (such as the Prospectus Regulation). If the issuer contemplates to offer or admit to trading asset-referenced tokens, the white paper needs to be approved by the regulator. Moreover, the issuer needs to have a **license** before it is allowed to issue asset-referenced tokens. Issuers of significant asset-referenced tokens are subject to additional requirements compared to issuers of other asset-referenced tokens. Issuers of significant asset-referenced tokens will fall under the direct supervision of EBA, rather than the national competent authority of its home Member State.

E-money tokens may only be offered or admitted to trading by licensed credit institutions or licensed e-money institutions (which will presumably change into a licensed payment institution having a license for the payment service of issuance of e-money, as expected upon PSD2 and EMD2 merging). E-money tokens are considered e-money (and therefore a form of funds within the meaning of PSD2). This will not only have regulatory consequences, but also civil law and property law consequences as it will then be clear that these e-money tokens represent a receivable against the issuer, can be pledged, transferred etc. in accordance with the current civil law frameworks.

MiCA also includes a set of requirements to which crypto service providers are subject. These include operational, prudential and organisational requirements, custody requirements and requirements in respect of information provision.

MiCA further includes rules that are derived from the Market Abuse Regulation; these rules aim at preventing market abuse in respect of crypto assets.

How the key information document under the PRIIPs Regulation and the whitepaper under MiCA correlate is not clear, but in our view PRIIPs Regulation may apply if the sub-categories of crypto assets that fall within the scope of MiCA qualify as packaged retail investment products (PRIIPs) as well.

The **Dutch government** embraces the proposed MiCA Regulation. It builds to the urgency and need of regulating the crypto industry which the Dutch government insisted on with the European legislator. The Dutch government would, however, prefer further clarification on the difference between the two types of stable coins. It also urges the European Commission to take further measures to better protect consumers. For example, the minimum capital requirement applicable to issuers of asset-referenced tokens is not clear according to the Dutch government. The Dutch government also welcomes clearer definitions for the crypto assets that fall under the scope of MiCA to prevent regulatory arbitrage (also due to the definitions of financial instruments under the existing MiFID Framework not being aligned in all Member States which would result in a specific crypto asset falling under the scope of existing regulatory framework in one Member State, and outside the existing regulatory framework in another Member State). Lastly, the Dutch government questions whether the proposed rules around white papers, such as the requirement to provide the whitepaper to the regulator but not subjected it to a substantive review by the regulator (other than white papers issued by asset-referenced token issuers) suffice to protect consumers and whether the proposed role of the regulator does not create false expectations.

PILOT FOR MARKET INFRASTRUCTURES BASED ON DLT

In the Digital Finance Package, explicit attention is given to the use of DLT for market infrastructures. A draft Regulation on a pilot regime for these DLT market infrastructures is published by the European Commission. The [draft Regulation](#) aims to take away regulatory obstacles by providing for a specific regime (including exemptions to existing EU legislation) for authorised operators of multilateral trading facilities (MTFs) and for authorised central securities depositories (CSDs) to **use DLT when operating their MTF or securities settlement system**. An example is an exemption to MiFID's requirement to only offer direct access to the trading venue to professional parties such as investment firms and credit institutions. Under the draft Regulation, MTFs would be able to give retail investors direct access to the 'DLT MTF' when trading in crypto assets that qualify as financial instruments.

It is a remarkable and rather new way of providing a regulatory framework by the Commission. In essence, it offers a temporary **regulatory sandbox to authorised operators of MTFs and authorised CSDs**. DLT market infrastructures could potentially combine trading, clearing and settlement in financial instruments and therefore could make capital market transactions more efficient, cheaper and quicker. In theory, the counterparty risk – and therefore the need for a clearing house be involved in a transaction – is taken away when DLT is used for trading and settlement. Use of DLT by authorised operators of market infrastructures could result in an incredible change in trading compared to the current standards.

The [Dutch government](#) is in favour of this draft Regulation offering a pilot regime for DLT market infrastructures, but it also needs clarification in respect of certain parts of the draft Regulation. We note that the Commission is looking into amending the SFD for the purpose of giving e-money institutions and payment institutions direct access to the payment systems such as TARGET2. The Dutch government will, presumably, request the Commission to look into the TARGET2 Securities system for the above purposes.

DRAFT REGULATION ON DIGITAL OPERATIONAL RESILIENCE

Lastly, as part of its Digital Finance Strategy, the European Commission also published a draft Regulation on the digital operational resilience for the financial sector (the [Digital Operational Resilience Act, DORA](#)). It aims at **aligning the requirements relating to the ICT risk for the financial sector** or, if these are not really existing as yet, to introduce such requirements for financial market actors. The current regulatory framework applicable to credit institutions, investment firms, asset managers, insurers, payment institutions etc. will be amended to subject each of these financial undertakings to the same set of rules as it comes to mitigate ICT risks involved in their respective businesses. It aims at introducing a set of requirements to manage and mitigate the risks of ICT incidents, a notification requirement for material ICT incidents, the requirement to periodically perform cyber resilience stress tests including, for significant financial undertakings the requirement to undertake threat led penetration testing which mimics a real-life cyber threat. DORA also includes a requirement to monitor the functioning of and risks imposed by third party service providers, such as cloud service providers, to whom financial undertakings have outsourced certain services. Lastly, DORA includes a proposal enabling financial undertakings to exchange information in respect of cyber threats.

The Dutch government attaches great value to digital operational resilience. There are already several operational requirements in place on a national level which are similar to the ones suggested in DORA, including the Dutch Act on Security Network and Information Systems. Pursuant to this act, companies that have at least 50 or more employees and/or generate a revenue of at least EUR10 million and provide essential services (eg, energy, banking, financial markets infrastructure) fall under the scope of the Act. They have a duty of care and must take adequate technical and organisational measures to control identified security risks.

Moreover, the Dutch Threat Intelligence Based Ethical Red Teaming model ([TIBER](#)) used for threat level penetration testing (TLPT) is already used in the Dutch market and taken over by the ECB as the model for TLPT within the EU.

The [Dutch government](#) endorses DORA in full, albeit that it will raise some questions for further clarification. It considers DORA a complete and proportionate framework based on the right principles which shall improve digital operational resilience and considers DORA to be an important step in harmonizing the operational requirements within the financial sector. According to the Dutch

government DORA ensures a better level of **cyber resilience** whilst not posing unnecessary obstacles for innovation. It will bring the TIBER model under the attention of the Commission to prevent a new EU TLPT model to be developed.

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