



## **UPDATED Q&A ON PILOT REGIME FOR USE OF DISTRIBUTED LEDGER TECHNOLOGY IN CAPITAL MARKET INFRASTRUCTURES**

In our newsletter from [13 April 2023](#), we described the new pilot regime for market infrastructures based on distributed ledger technology<sup>1</sup>. ESMA has now updated its Q&A<sup>2</sup> and in this newsletter, we elaborate on some of our initial thoughts on the DLTR and describe relevant interpretative statements made by ESMA.

ESMA has now confirmed that the financial instruments issued via the distributed ledger technology (“**DLT**”) will have the same ISIN as the non-DLT financial instrument, provided that the characteristics of the instruments are the same and that the only difference is the underlying technology used for creating the instrument. If the non-DLT financial instrument and the DLT version are not fully fungible, the issuer should assess whether the DLT financial instrument should have its own ISIN<sup>3</sup>. ESMA notes that a non-DLT financial instrument and a DLT

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<sup>1</sup> Regulation (EU) 2022/858 of 30 May 2022 regarding a pilot regime for market infrastructures based on distributed ledger technology (the “**DLTR**”).

<sup>2</sup> ESMA Q&A on a pilot regime for market infrastructures based on distributed ledger technology last updated on 2 June 2023 (ESMA70-460-189) (“**ESMA Q&A**”).

<sup>3</sup> ESMA Q&A, Q.1/A.1, p. 14-15.

financial instrument can be fungible despite the fact that the register of a traditional CSD and a DLT financial infrastructure are not technically linked in such a way that they ensure seamless interchangeability<sup>4</sup>.

ESMA has also addressed the scope of DLT financial instruments. In our first article, we stated that the definition of a DLT financial instrument seems to imply that only newly issued financial instruments are covered by the definition of a DLT financial instrument (financial instruments that are “... *issued*”<sup>5</sup>). However, the ESMA Q&A confirms that existing non-DLT financial instruments can be digitally issued on the DLT as a DLT financial instrument. Consequently, the DLTR allows for both the issuance of new DLT financial instruments and of existing non-DLT financial instruments<sup>6</sup>. The latter mechanism implies that a non-DLT financial instrument is recorded and thereby represented in a tokenized form on a DLT after which it becomes a DLT financial instrument. The new DLT financial instrument will in this case serve as the main reference point for further events relating to the financial instrument, e.g., as trading and settlement<sup>7</sup>.

ESMA has clarified that securities financing transactions, e.g., REPOs or securities lending transactions, are not admissible within the DLTR<sup>8</sup>. The rationale is that such transactions usually consist of multiple transactions and that the object of the DLTR is to enable DLT-based experimentation with financial instruments, which are more easily understood by investors and less complex to handle by the DLT market infrastructure.

ESMA has confirmed that a non-DLT financial instrument may be issued partially as a DLT financial instrument. Partial tokenization is the scenario where a specific portion of a financial instrument is issued as a DLT financial instrument, while the remaining part of that financial instrument continues to exist as a non-DLT financial instrument. This allows greater flexibility for issuers when experimenting with DLT issuances as the issuer may limit its exposure to the DLT portion of the financial instrument.

ESMA has also addressed the question of whether DLT MTFs are allowed to organize trading of DLT financial instruments using other technologies than DLT. The DLTR does not require that DLT financial instruments are traded using DLT<sup>9</sup>, only that they are issued, recorded, transferred, and stored using DLT. Consequently, there is no requirement for a DLT MTF to organize the trading of DLT financial instruments using blockchain technology (on-chain). The key aspect of the DLTR is that DLT is used for maintaining accounts and records

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<sup>4</sup> ESMA Q&A, section 7, Q.3/A.3, pages 18-19.

<sup>5</sup> DLTR Art. 2(11).

<sup>6</sup> DLTR preamble no. 3.

<sup>7</sup> ESMA Q&A, section 7, Q.2/A.2, pages 17-18.

<sup>8</sup> ESMA Q&A, section 7, Q.6/A.6, pages 20-21.

<sup>9</sup> DLT Art. 2(6) & Art. 2 (11).

pertaining to the title of a financial instrument and to facilitate the transfer of such titles between market participants<sup>10</sup>.

With respect to settlement of securities transactions with e-money/tokenized cash, ESMA clarified the meaning of the term in context of DLTR. Moreover, ESMA states that DLTR does not require e-money tokens used for settlement of transactions in DLT financial instruments to be on the same DLT as the financial instrument. DLT market infrastructures are free to use distinct DLTs for the cash and asset part of a transaction when settling the transaction.

As stated in our first newsletter, a DLT settlement system can be exempt from various requirements relating to CSDs, importantly the requirement for transferable listed securities to be issued and recorded in book-entry form in the CSD<sup>11</sup>. ESMA has now clarified that unless a DLT MTF (multilateral trading facility) is also authorised as a DLT TSS (a facility combining the services of a DLT MTF and a DLT settlement system), any transaction in transferable securities taking place on that DLT MTF must be recorded in book-entry form in a CSD<sup>12</sup>.

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<sup>10</sup> ESMA Q&A, section 8, Q.1/A.1, page 21.

<sup>11</sup> DLTR Art. 5(2).

<sup>12</sup> ESMA Q&A, section 10, Q.2/A.2, page 24.

**If you have any questions or require further information regarding any of the above, please do not hesitate to contact us.**



Dan Moalem  
Partner  
[Dan.moalem@moalemweitemeyer.com](mailto:Dan.moalem@moalemweitemeyer.com)



Joachim Buznicki Nørlem  
Senior Associate  
[Joachim.noerlem@moalemweitemeyer.com](mailto:Joachim.noerlem@moalemweitemeyer.com)



Kadir Kurt  
Associate  
[Kadir.kurt@moalemweitemeyer.com](mailto:Kadir.kurt@moalemweitemeyer.com)

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