MAY. 21

INFORMATIVE NOTE

BANKING AND FINANCE

Proposal for a European regulation on markets in crypto-assets

I. Background

The Proposal for a Regulation of the European Parliament and of the Council on markets in crypto-assets, which amends Directive (EU) 2019/1937, ("Regulation on Markets in Crypto-assets", or the "MiCA Regulation" for short) was published on 24 September 2020[1].

The Proposal is part of the Digital Finance Package adopted on the same date by the European Commission as part of the Digital Finance Strategy for the EU financial sector[2]. This includes several regulatory proposals on digital currencies and digital operational resilience[3], as well as a pilot regime for market infrastructures based on Distributed Ledger Technology ("DLT")[4].

The MiCA Regulation is, therefore, one of the four priorities for digital transformation identified by the European Commission. These priorities are to:

i) create a dedicated, specific and harmonised framework at European Union level for the issuance of crypto-assets not covered by European financial services legislation and for the provision of related services;

ii) support innovation and fair competition through a secure and proportionate legal framework;

iii) ensure consumer protection and the integrity of the markets in crypto-assets;

iv) ensure financial stability within the Single Market and mitigate the risks that may arise, for monetary policy, from crypto-assets that seek to stabilise their price by reference to a fiat currency that is legal tender, an asset, a commodity or a basket of those assets (known as "stablecoins").

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1 The text of the Proposal is available for consultation here.
2 Available for consultation here.
3 Proposal for a Regulation of the European Parliament and of the Council on digital operational resilience of the financial sector, which amends Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014 and (EU) No 909/2014 - COM(2020)595, available here.
4 Proposal for a regulation of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology - COM(2020)594, available here.

II. Scope and exclusion

The MiCA Regulation Proposal appears in this context and it will apply to entities engaged in the issuance of crypto-assets or the provision of services relating to crypto-assets in the European Union[5].

Excluded from the scope of the Regulation are, first and foremost, crypto-assets that can be equated with financial instruments[6], within the meaning of Article 4(1)(15) of the Directive on Markets in Financial Instruments (MiFID) II[7]. The typical case involves "investment" crypto-assets (known as "investment tokens" or "security tokens"), which attribute economic rights linked to the performance of a given project in a similar way to typical financial instruments.

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In this regard, it will remain essential to assess whether the features of the crypto-assets to be issued are comparable with or equivalent to those of a financial instrument subject to securities regulation. Examples of these features are representation, even if digital, transferability, negotiability on markets, homogeneity, or functional comparability with other typical securities. This assessment is necessary to define the scope of the rules that will apply to such crypto-assets, both when they are issued and with regard to the services provided in relation to them.

Crypto-assets equivalent to electronic currencies are also excluded from the scope of application of the Regulation (except in the cases provided for in the Regulation)[8].

III. Definition of crypto-assets

It is necessary to create a legislative framework in the field of crypto-assets that is at the same time specific, viable in the long term and able to keep pace with innovation and technological developments. Therefore, the MiCA Regulation Proposal adopts an intentionally broad definition of "crypto-asset": the text of the Proposal defines "crypto-asset" as "a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology[9] or similar technology"[10].

According to the explanatory memorandum of the Proposal, the aim of this rather broad definition is precisely to regulate all types of crypto-assets that are currently outside the scope of European legislation, as well as crypto-assets that may be created in the future.

5 See Article 2(1) of the Proposal.
6 See Article 2(2)(a) of the Proposal.
7 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014, available for consultation here.
8 See Article 2(2)(b) to (e) of the Proposal.
9 It should be noted, in this context, that the notion of "distributed ledger technology" adopted in the Proposal is also quite broad: "a type of technology that supports the distributed recording of encrypted data" (See Article 3(1((1) of the Proposal).
10 See Article 3(1)(2) of the Proposal.

The MiCA Regulation distinguishes three sub-categories of crypto-assets:

i) The "utility token", whose primary function is to provide digital access to a good or service, available on DLT which is only accepted by the issuer of that token[11];

ii) The "asset-referenced token" is a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets[12];

iii) The "electronic money token" or "e-money token" is a type of crypto-asset whose main purpose is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender[13] ("currency tokens", also known as "cryptocurrencies" or, in the meaning of the Fifth Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing[14], "virtual currencies", whose primary aim is to be used as a means of payment in similar terms to electronic money[15]).

These definitions and the classification of each crypto-asset is essential under the MiCA Regulation framework, because it defines the scope of rules applicable to the offer and admission to trading of the crypto-assets in question.

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IV. Requirements applicable to the issuance or admission to trading of crypto-assets

○ Crypto-assets in general

If a crypto-asset is not considered to be an e-money token or an asset-referenced token, its issuance or admission to trading on a crypto-asset trading platform requires the preparation, notification to the competent authority and publication of a white paper. This paper must contain a set of mandatory disclosure information, such as general information on the issuer, the project to be carried out with the capital raised, the public offer of a crypto-asset or its admission to trading on a crypto-asset trading platform, the rights and obligations attached to the crypto-asset, the underlying technology used and the related risks[16].

11 See Article 3(1)(5) of the Proposal.
12 See Article 3(1)(3) of the Proposal.
13 See Article 5(1)(3) of the Proposal.
14 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, available here.
15 Se article 2(2) of Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, available here.
16 See Articles 4 to 7 of the Proposal.

The Regulation provides exceptions to this obligation: (i) where the crypto-assets are offered for free or are unique and not fungible with other crypto-assets, (ii) when the crypto-assets are automatically generated by mining, as a reward for maintaining the DLT or for validating transactions, (iii) when offers of crypto-assets are addressed to fewer than 150 natural or legal persons per Member State (where those persons are acting on their own behalf), (iv) when the total value of a public offering of crypto-assets does not exceed the amount of EUR 1 million (or the equivalent amount in another currency or in crypto-assets) over a period of 12 months, or (v) when the public offering concerns crypto-assets that are exclusively aimed at qualified investors and can only be held by them. The aim of some of these exceptions is to take a proportionate approach and reduce the administrative burden for early stage projects.

Issuers must send the white paper and marketing communications (if any) to the competent authority (i) before any public offering of crypto-assets is launched, or (ii) before the crypto-assets are admitted to trading on a crypto-asset trading platform. Prior approval by the competent authority is not required.

- **Asset-referenced tokens**

Asset-referenced tokens give rise to more significant risks to consumer protection and market integrity. As a result, they can only be offered to the public or admitted to trading on a crypto-asset trading platform after the issuer has been authorised by the competent authority and the white paper prepared by the issuer has been approved by the same authority. Additional content requirements will apply to the white paper, such as detailed descriptions of the issuer's governance arrangements, asset pooling and custody arrangements for the pooled assets, including the segregation of assets. The authorisation granted allows the issuer to offer the asset-referenced tokens for which it has been authorised, or to apply for their admission to trading on a crypto-asset trading platform across the European Union[17].

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The credit institutions authorised under Directive 2013/36/EU of the European Parliament and of the Council are exempt from the obligations to obtain an authorisation from the competent authority and to obtain prior approval of the white paper. To issue or apply for admission to trading of asset-referenced tokens, these entities will only need to draw up a white paper and send it (and the commercial communications, if any) to the competent authority before its publication.

In addition, specific obligations apply to issuers of these types of crypto-asset securities regarding the; (i) periodic information to be provided to crypto-holders, (ii) procedures for handling complaints received from crypto-asset holders, (iii) prevention, identification, management and disclosure of conflicts of interest, (iv) soundness of their governance systems, (v) capital requirements, (vi) establishment of an asset pool (where more than one class of asset-referenced token is offered, each class must have a separate asset pool), (vii) the custody of the pool assets, and (viii) limitations on the investment of the pool assets. There is also an obligation to implement an orderly wind-down plan[18].

17 See Title III, Chapter 1 of the Proposal.
18 See Title III, Chapters 2, 3 and 6 of the Proposal.

Asset-referenced tokens may be classified as "significant". This classification can be applied voluntarily by the issuer or the EBA, taking into account criteria relating to the (i) customer base of the promoters of these crypto-assets or the shareholders of the issuer, (ii) the value of crypto-assets issued, (iii) the number and value of transactions relating to these crypto-assets, and (iv) the size of the asset pool, among others). When asset-referenced tokens receive the classification of "significant", their issuers are subject to more stringent requirements. They are, in particular, subject to higher capital requirements, interoperability requirements and they must define a liquidity management policy[19].

- **E-money tokens**

Issuers will be required to be authorised as a credit institution under Directive 2013/36/EU or as an electronic money institution under Directive 2009/110/EC in order to launch a public offering of e-money tokens or to apply for admission to trading on a crypto-asset trading platform in the European Union. They must also comply with the relevant operational requirements of the latter Directive. Issuers will also have to prepare a white paper and send it, together with other existing marketing communications, to the competent authority. Again, no prior approval of the white paper by the competent authority is required[20].

"When asset-referenced tokens receive the classification of "significant", their issuers are subject to more stringent requirements."

The need to obtain authorisation as a credit institution or electronic money institution will not apply to offers or admissions to trading of e-money tokens (i) that are marketed, distributed and held by qualified investors and can only be held by qualified investors, or (ii) where the average amount of e-money tokens does not exceed the threshold of EUR 5 million (or the corresponding equivalent in another currency) over a period of 12 months[21].

Another essential requirement for the issuance of e-money tokens is their holders will be provided with a claim against the issuer. This claim must enable them, upon request and at any time, to redeem from the issuer the monetary value of the e-money tokens they hold at par value in cash or by bank transfer. Redemption must be processed by the issuer within the period specified in the white paper. This may not exceed 30 days, and may only be subject to a fee if so stated in the white paper[22].

E-money tokens may also be classified as significant and the criteria for classification are the same as those used to classify asset-referenced tokens as significant. When e-money tokens receive this classification, higher capital requirements, interoperability requirements and the obligation to have a liquidity management policy apply to their issuers. They must also comply with certain requirements applicable to issuers of asset-referenced tokens, such as custody requirements and investment rules for reserve assets and the obligation to establish an orderly wind-down plan[23].

19 See Title III, Chapter 5 of the Proposal..
20 See Title IV, Chapter 1 of the Proposal.
21 See Article 43(2) of the Proposal.
22 See Article 44 of the Proposal.
23 See Title IV, Chapter 2 of the Proposal.

V. Provision of crypto-asset services

Under the Regulation Proposal, crypto-asset services can only be provided by legal entities that have their registered office in a Member State and have been authorised as crypto-asset service providers by the competent authority of the Member State where that registered office is located. Crypto-asset service providers will subsequently be registered with the ESMA, which will maintain a register of authorised providers that is publicly accessible via its website[24].

The crypto-asset services provided for the MiCA Regulation are[25]:

i) the custody and administration of crypto-assets on behalf of third parties;

ii) the operation of a trading platform for crypto-assets;

iii) the exchange of crypto-assets for fiat currency that is legal tender;

iv) the exchange of crypto-assets for other crypto-assets;

v) the execution of orders for crypto-assets on behalf of third parties;

vi) placing of crypto-assets;

vii) the reception and transmission of orders for crypto-assets on behalf of third parties;

viii) providing advice on crypto-assets;

There are obligations on crypto-asset services providers, in addition to specific obligations for each of the types of services provided. These relate to requirements, organisational requirements, implementation of measures to protect crypto-assets and client funds, implementation of complaint handling procedures, and prevention, identification, management and disclosure of conflicts of interest[26].

VI. Implementation

No definitive date for the Regulation's entry into force has been set yet. However, in the Digital Finance Strategy for the EU, the European Commission expresses its expectation to implement this legislative framework by 2024. ■

24 See Title IV, Chapter 1 of the Proposal.
25 See Article 4(1)(8) to (17) of the Proposal.
26 See Title V, Chapters 2 and 3 of the Proposal.