EU Crypto regulation expected for 2023 (Series | Part 1 – MiCA)

Getting up to speed with MiCA – Key considerations for firms (potentially) subject to MiCA

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HVG LAW

1. Introduction

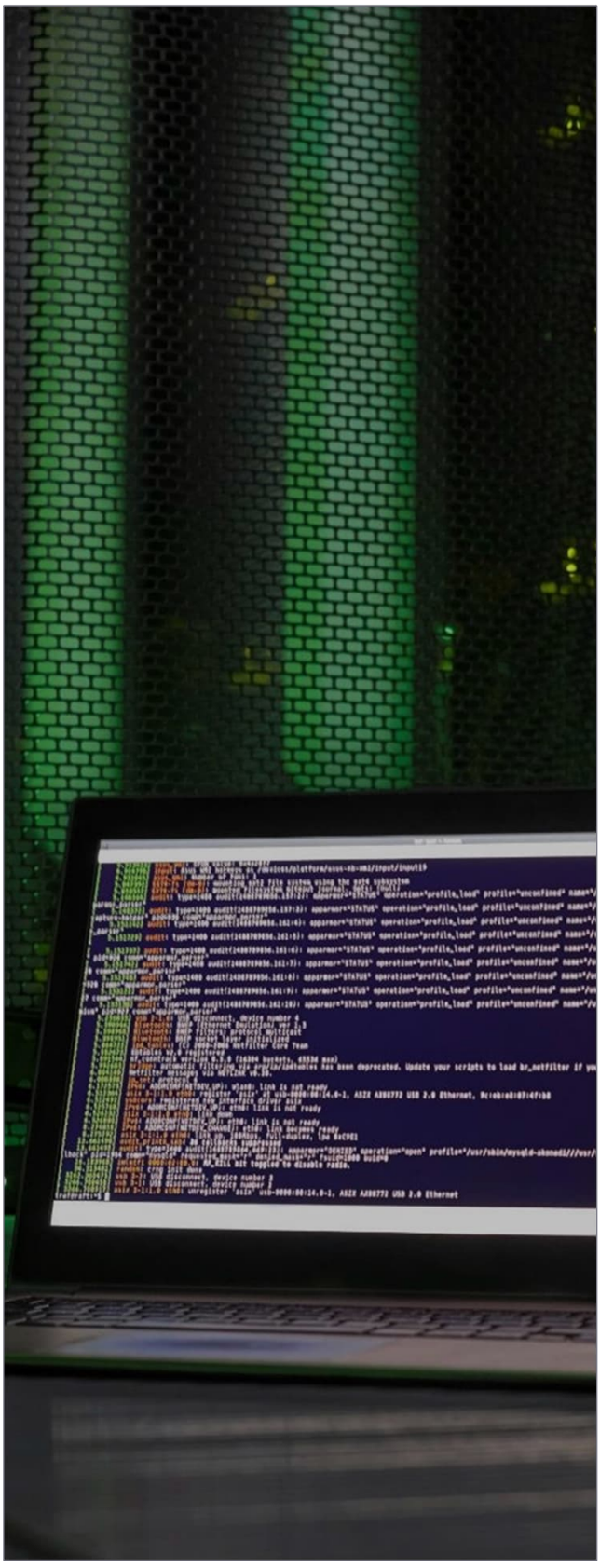
It has been little over two years since the European Commission proposed the new regulation of Markets in Crypto-Assets (MiCA). On 5 October 2022 the European Council approved of its position on the MiCA regulation. Shortly thereafter, on 10 October 2022, the Committee on Economic and Monetary Affairs (ECON) voted to confirm the proposal for the MiCA regulation. The current version of the MiCA regulation is not officially adopted, as it awaits a vote from the larger European Parliament plenary. The vote was delayed twice and we now expect the final MiCA plenary vote to take place around April 2023. When adopted, we expect the regulation to take effect from the second half of 2024[1].

In anticipation of MiCA introducing a comprehensive legal framework harmonising the regulatory requirements for crypto-asset related services across Europe, crypto firms[2] (firms) are starting to get up to speed on MiCA and in particular, are determining what it could mean for their (future) business models (including their licence to operate).

In part 1 of this series we will discuss several main considerations firms should take into account when determining whether they are subject to MiCA and, if so, when to be "MiCA compliant". In part 2 of the series we will discuss the potential impact of the proposed EU Transfer of Funds Regulation (TFR) on firms. For a general overview of MiCA, please refer to our previous Law Alert[3].

Finally, in view of the current MiCA text[4] not yet being final, there is a possibility for certain provisions and interpretations thereof to be amended once the text is finalised. The following topics will be covered in this client alert:

- Scope of MiCA
- Obligations for issuers of crypto-assets
- Crypto-Asset Service Providers (CASPs)
- Other relevant MiCA related considerations
- Considerations for firms aiming to be MiCA compliant
- What HVG Law and EY can do for you



[1] Note that since MiCA is a regulation it applies directly and does not need to be transposed into local law.

[2] The term crypto firm refers to firms undertaking any crypto-related activities or offering crypto-related products.

[3] Please reach out to us for a copy of our previous Law Alert

[4] As of January 2023.

2. Scope of MiCA

Territorial scope

Perhaps the least top of mind consideration when determining the impact of MiCA, is its territorial scope. The territorial scope of MiCA is key, however, when determining whether a firm must be established in the EU when providing crypto-assets related services. Under MiCA, the rules apply if crypto-assets are offered to the public, admitted to trading on a trading platform for crypto-assets or where crypto-asset services are provided in the EU. Also, the issuance of asset-referenced tokens (ARTs), electronic money tokens (EMTs) and the provision of crypto-asset services will require an establishment in the EU, effectively excluding third-country entities from these activities. Firms aiming to issue crypto-assets other than ARTs and EMTs in the EU are, in contrast to ARTs and EMTs, not required to be established in the EU.

Persons in scope of MiCA

MiCA applies to all natural and legal persons that are engaged in:

- Issuance/Offering to the public of crypto-assets
- Admission to trading of crypto-assets
- Provision of services related to crypto-assets in the Union

MiCA however exempts certain parties from several requirements, the most notable exemptions concern firms which are already subject to financial regulatory supervision. For instance, credit institutions authorised under the EU Capital Requirements Directive (CRD)[5] are exempt from authorisation requirements when issuing ARTs and providing crypto-asset services. Besides E-money institutions, credit institutions are also the only eligible issuers of EMTs. Additionally, central securities depositories, investment firms, market operators, E-money institutions, management companies of UCITs or alternative investment funds are allowed to provide crypto-assets services, provided article 53a of MiCA is complied with.

Crypto-assets in scope

Below we discuss whether crypto-assets are currently subject to any regulatory regime and elaborate on which crypto-assets are in scope under MiCA.

Pre-MiCA

Currently, the classification of a crypto-asset as a financial instrument depended largely on the specific characteristics of the crypto-asset and the way it is used. The EU has established a framework for the regulation of financial instruments, which is set out in the MiFID (Markets in Financial Instruments Directive)[6]. Under the MiFID framework, "financial instruments" are defined as any transferrable securities, financial contracts for differences (CFDs), options, futures, swaps and forward rate agreements. Some crypto-assets may be considered transferrable securities if they meet the criteria set out in the MiFID definition. Other crypto-assets, such as stablecoins, may (theoretically) be classified as electronic money (E-money) should they meet the criteria set out in the EU's Electronic Money Directive (EMD). This classification is generally based on the fact that stablecoins are typically issued by a central issuer and are intended to be used as a means of payment. Note however that there is currently no pan-European consensus on whether stablecoins should be seen as E-money and, if so, whether the EMD framework should apply to stablecoins. With MiCA, a harmonised regulatory framework will be created for stablecoins.

Under MiCA

MiCA sets out to regulate primary market (i.e. issuance and public offerings) and access to the secondary market (i.e. listings) activities well as the provision of certain crypto-related services. MiCA is built on the principle that it regulates several activities related to crypto-assets.

[5]Directive 2013/36/EU.

[6]Directive 2014/65/EU.

The term “crypto-asset” is broadly defined in MiCA as “digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology or similar technology”[7]. MiCA is now expanding the scope of crypto-assets to include new asset classes while keeping others out of scope. MiCA recognises three main types of crypto-assets:

- E-money tokens (EMT), which stabilise their value by referencing only one single official currency (e.g., the EUR-L, EUROC or USDC stablecoins)
- Asset-referenced tokens (ART) which stabilise their value by referencing any other value or right (e.g., PAX Gold or DIAM)
- Other crypto-assets, such as utility tokens, which do not fall in the two other categories (e.g., the gaming currency, MANA, or BNB, which is used by the Binance exchange)

Furthermore, both ARTs and EMTs are variants of what is currently referred to as “stablecoins”. Under MiCA, both ARTs and EMTs may be designated as significant by the European Banking Authority (EBA) based on a prescribed set of criteria such as the number of holders, market capitalisation, gatekeeper status of their issuer or interconnectedness with the financial system. Issuers of significant ARTs (SARTs) and EMTs (SEMTs) are subject to more rigid rules, e.g., regarding capital requirements and will generally be
supervised by EBA instead of national competent authorities.

Crypto-assets currently not covered by MiCA

As mentioned, MiCA does not apply to crypto-assets captured by existing financial services legislation (e.g., security tokens qualifying as financial instruments under MiFID).

MiCA also does not apply to crypto-assets that are unique and not fungible with other crypto-assets, further to article 2(2a) MiCA; so-called Non-Fungible Tokens (NFTs).

Note however, NFTs that are issued in a large series or collection, will under MiCA, be considered as an indicator of their fungibility. The sole attribution of a unique identifier to a crypto-asset is not sufficient to classify it as a unique or not fungible[8]. MiCA clarifies that the assets or rights represented should also be unique and not fungible for the crypto-asset to be considered unique and not fungible[9].

Furthermore, fractional parts of NFTs also do not fall under the exclusion. In short, firms will need to determine whether their current or future NFTs fall under the MiCA NFT exemption, rather than just assume that all NFTs are exempted.

Crypto-asset services that “are provided in a fully decentralised manner without any intermediary” and crypto-assets without an identifiable issuer, also do not fall within the scope of MiCA[10]. This includes for example, Decentralised Finance (DeFi) and Decentralised Autonomous Organisations operations (DAOs), provided that control of the operations is truly decentralised.

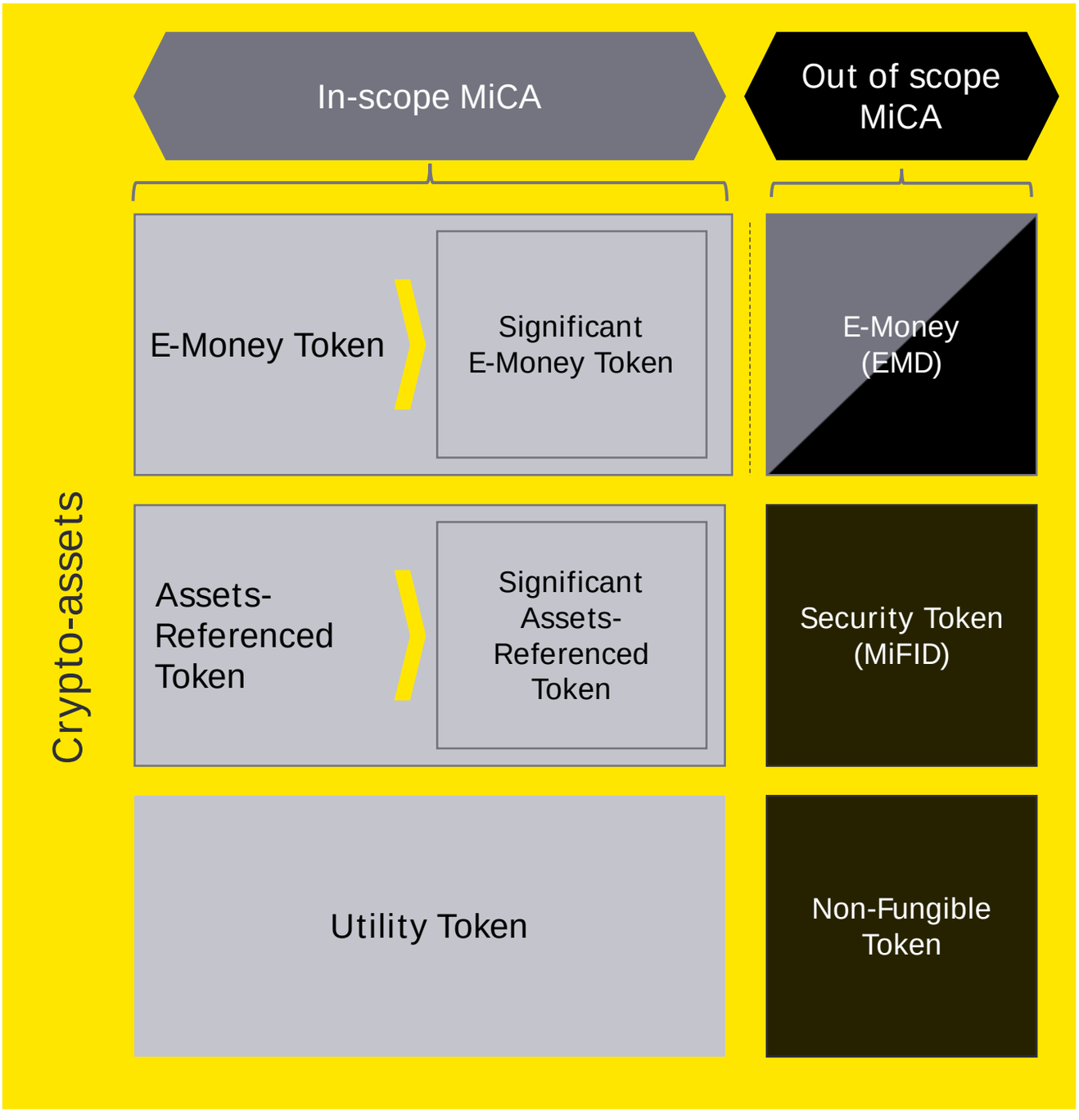
The table below *(refer the next slide)* illustrates which regime applies to the different tokens.

[7]See article 3(1) number 2 of MiCA.

[8]See recital 6c of MiCA.

[9]See recital 6c of MiCA.

[10]See recital 12a of MiCA


In-scope MiCA
Out of scope MiCA
Crypto-assets
E-Money Token
Significant E-Money Token
E-Money (EMD)
Assets-Referenced Token
Significant Assets-Referenced Token
Security Token (MiFID)
Utility Token
Non-Fungible Token

3. Obligations for issuers of crypto-assets

General rules for issuers of crypto-assets

Any firm intending to offer or admit crypto-assets to a trading platform is subject to specific procedural and conduct rules. Key examples in this respect are:

- Drafted a white paper[11] in accordance with the prescribed rules prior to offering a crypto-asset to the public or list it on a trading platform. The contents of the white paper will vary depending on the type of crypto-asset, but all white papers must contain information on the issuer, information on the crypto-asset, information on the underlying technology, and the associated risks[12]. Note also that advertising and marketing communications must be consistent with the contents of the white paper.
- The white paper must also include information on the adverse environmental and climate-related impacts of the consensus mechanism used to issue the crypto-assets.
- The offering of crypto-assets shall only be made by a legal person; however MiCA does not require the legal person to be established in the European Union[13].
- The notification of the white paper and all marketing communications, if any, to the competent authority should occur at least 20 working days prior to its publication.
- The offering of crypto-assets to the public or the listing of crypto-assets on a trading platform does not require prior authorisation from the EBA. Issuers of crypto-assets other that ARTs and EMTs only need to notify and publish the white paper up front.
- The compliance with certain good conduct and organisational requirements.
- The publication of the white paper must occur no later than the day the offering commences.

Finally, note that the requirements above do not apply where the crypto-assets are offered only to qualified investors.

Specific rules for issuers of ARTs

In addition to the rules above, MiCA introduces specific and - in some instances - stricter rules for the stablecoin variants of crypto-assets (i.e. EMT and ART). This is due in large part to the concerns with regard to financial stability and monetary sovereignty. With respect to ARTs some of the specific rules are:

- The issuance of ARTs will require prior authorisation from the competent authority. The information which needs to be submitted as part of the authorisation procedure will be set out in regulatory technical standards which need to be developed by the EBA in cooperation with ESMA. Taking into account the procedural steps in order to obtain an authorisation to issue an ART, the timeframe for such authorisation is likely to be in the range of a seven to eight months of minimal processing period. This period does not include the preparation of the application. The exact time period however will depend on the specific issuances.
- The issuer of ARTs must also be established in the EU.
- The issuer of ARTs is subject to transparency rules.
- The issuers of ART will be subject to own funds requirements of at least the highest of EUR 350,000; or 2% of the average amount of the reserve assets; or a quarter of the fixed overheads of the preceding year.

[11]Similar to a prospectus for crypto-assets, informing potential holders of the characteristics of the issued crypto-asset.

[12]The exact contents can be found in an annex supplementing MiCA.

[13]See the sections below for specific rules for ART and EMT issuers.

- The issuers of ARTs are required to include an obligation to maintain a reserve of assets. This is due to MiCA stipulating the right of ART investors to redeem their tokens at any time. The reserve requirements will therefore ensure issuers will not run into any liquidity risks when faced with a large number of simultaneous redemption requests. As a result, the reserve always needs to match the full value of the total outstanding holders' claims.

- The issuers of ART will be subject to a comprehensive set of conduct and organisational rules. Some of these rules are for example, robust governance and internal control arrangements, complaint handling procedures and conflicts of interest management.

- The white paper for an ART will be subject to increased requirements. Mostly reflecting the deviating requirements in relation to the issuer of the ART.

MiCA also introduces a further sub-category of ART, the significant ART (SART). The EBA will be tasked with classifying ARTs as SARTs based on certain criteria including the size of the customer base, the value of the ARTs issued, the number of transactions, the size of the reserve, the significance of the cross-border activities and the interconnectedness with the financial system. Issuers of
SARTs will be subject to the following additional obligations:

- The issuer needs to have a remuneration policy that promotes sound and effective risk management.

- The issuer's own funds requirement is increased.

- The issuer must implement and maintain a liquidity management policy to ensure redemption requests can be fulfilled.

- The issuer shall ensure that the SART can be held in custody on a fair, reasonable and non-discriminatory basis by crypto-asset custodians, including custodians which do not belong to the same group of companies as the issuer.

Specific rules for issuers of EMTs

EMTs may only be offered by credit institutions and E-money institutions authorised under the applicable EU laws.
The rules for EMTs follow the regulatory requirements applicable to E-money under the E-Money Directive (Directive 2009/110/EC), unless MiCA provides for derogations or specifications. A key element is a mandatory redemption right which must be granted to all holders of EMTs.

Additionally, similar to the approach for ARTs, the EBA may also classify EMTs as significant EMTs (SEMT). The additional rules applying to issuers of SEMTs are similar to those that apply to the issuers of SARTs.

4. Crypto-asset Service Providers (CASPs)

Authorisation

A considerable part of MiCA introduces a harmonised regulatory regime for crypto-assets service providers (CASPs). MiCA provides a total of 10 services defined as “crypto-asset services”, which mimics the list of investment services under MiFID. CASP is defined under MiCA as “any person whose occupation or business is the provision of one or more crypto-asset services to third parties on a professional basis.”

In order to provide crypto-asset services, firms will need to receive prior authorisation from the competent authorities, which will be valid across the European Union. However, credit institutions, central securities depository, investment firms, market operator, E-money institutions, management.

companies of UCITs or alternative investment funds are allowed to provide crypto-assets services, provided article 53a MiCA is complied with. Furthermore, where an EU member state has already established a bespoke registration/licensing regime for VASPs (virtual asset service provider), regulators will apply a simplified authorisation process to help firms transition from a national registration/license to a MiCA CASP licence that is valid across the whole European Union. For completeness sake the CASP’s definition introduced by MiCA, is broader than the Financial Action Task Force’s (FATF) virtual asset service provider (VASP) definition. The reason for a broader definition was to ensure that MiCA applies to most crypto firms and to future-proof it against market niches that do not exist yet. The table below illustrates: the virtual asset-services under FATF and the EU AMLD-framework; and the crypto-asset services under MiCA:

Virtual-asset services under FATF	Virtual-asset services under EU AMLD-framework	Crypto-asset services under MiCA
▸ Exchange between virtual assets and fiat currencies ▸ Exchange between one or more forms of virtual assets ▸ Transfer of virtual assets ▸ Safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets ▸ Participation in and provision of financial services related to an issuer’s offer and/or sale of a virtual asset	▸ Virtual-fiat exchange providers ▸ Custodian wallet providers are regulated for AML/CTF purposes	▸ Custody and administration of crypto-assets on behalf of third parties ▸ Operation of a trading platform for crypto-assets ▸ Exchange of crypto-assets for funds ▸ Exchange of crypto-assets for other crypto-assets ▸ Execution of orders for crypto-assets on behalf of third parties ▸ Placing of crypto-assets ▸ Providing transfer services for crypto-assets on behalf of third parties ▸ Reception and transmission of orders for crypto-assets on behalf of third parties ▸ Providing advice on crypto-assets ▸ Providing portfolio management on crypto-assets

Also, compared to the authorisation processes for the issuance of ART, the authorisation process for CASPs appears to be less complex and, therefore, provides for shorter processing periods when received by the competent authorities. Competent authorities shall issue their decision within three months upon submission of a complete application. CASPs will be registered in the central register maintained by ESMA. Once authorised, CASPs will be able to provide crypto-asset services in all EU Member States based on a passporting procedure which allows provisions of services across the EU not later than 15 days following submission of the passport application.

When MiCA becomes applicable, firms already providing crypto-asset services in accordance with national laws, can utilise grandfathering/ transitional provisions under MiCA which will give firms more time to become authorised under MiCA. For example, existing CASPs may continue to provide their services in accordance with national law for an additional 18 months after MiCA comes into effect. In some cases, such firms may also benefit from a simplified authorisation procedure.

CASP requirements

CASPs will be subject to general rules, as follows:

- Act fairly and in the interest of clients
- At least one director to be a resident in the EU
- Place of effective management in the EU
- Members of management and qualifying shareholders (10%) to be fit and proper
- Prudential and organisational requirements
- Safekeeping of assets and funds
- Complaint handling procedures
- Preventing, managing conflicts of interests
- Outsourcing requirements
- Other policies including orderly wind-down

Also, firms offering custody services are required to establish a custody policy with segregated holdings, daily reporting of holdings and have liability for loss of client's crypto-assets in the event of malfunctions or cyber-attacks. Moreover, CASPs will be obliged to place clients' funds received with a central bank or credit institution (exemption for e-money) at the end of every business day.

5. Other relevant MiCA related considerations

- Custody responsibility: CASPs that provide custody services will be responsible and have to put mechanisms in place in order to protect consumers wallets. CASPs will be liable in case of loss of investors assets, unless they can prove that the loss has been caused by an external event out of reasonable control.
- Insider trading: MiCA will include elements to prevent insider trading, unlawful disclosure of inside information, market manipulation etc. with regards to crypto-assets.
- Loyalty tokens: Loyalty tokens that cannot be transferred are excluded from the scope.
- Public register: ESMA will operate and maintain a public register of non-compliant entities for all member states. In addition, EBA will also oversee the crypto markets.
- Customer protection: In view of the lack of harmonized EU consumer protection rules MiCA introduces several provisions which CASPs and other stakeholders need to observe.
- Supervision: As the supervision at EU level will involve, to different degrees, three different supervisors: ESMA, EBA and ECB. Hence, it will be important for firms to have a good understanding of what roles (and when) each of them plays.

6. In conclusion - some considerations for firms aiming to be MiCA compliant

- With the adoption of MiCA around the corner, it is critical for firms who are currently/planning to i) issue crypto-assets; ii) provide crypto-asset services; iii) distribute crypto-assets to customers in the EU, to review MiCA closely and determine the impact of its application to their current and proposed business model.
- Firms should also start to consider the creation of a crypto-asset categorisation policy that will help them determine whether any of their products and services, or those of their partners, fall within the definition of a crypto-asset and, if so, whether they may also be asset-referenced tokens or E-money tokens. Categorising particular crypto-assets for these purposes will be essential for compliance with MiCA, as the application of the different rules under MiCA is determined by such categorisation. Mis-categorisation of a particular crypto-asset could therefore carry significant compliance risks.
- Firms should also consider embedding such categorisation assessments into their due diligence processes. In that regard, note that ESMA will maintain a crypto-asset blacklist. This will include issuers and crypto-asset service providers that are not compliant with MiCA. Firms may wish to include the ESMA blacklist in the sources they use for due diligence and broader risk-management purposes.
- In addition to setting up technical infrastructure required to meet certain MiCA requirements, firms should also consider training relevant/key staff in order to carry out the (new) business activities adequately.
- Under MiCA, the topic of risk management also requires additional attention from firms, where, inter alia, an ongoing calculation of the risk from positions held in crypto-assets is essential as a basis for controlling position limits and, if necessary, the creation of reserve assets, which act as collateral and risk cover for issuers of asset-referenced tokens.
- Finally, issuers must establish liquidity management policies to maintain reserve assets at all times. In this regard, the reserve assets may only be invested in highly liquid financial instruments with minimal market and credit risk. This allows the issuer to be in a position to liquidate the reserve at any time and to react to short-term market fluctuations.

7. What HVG Law can do for you

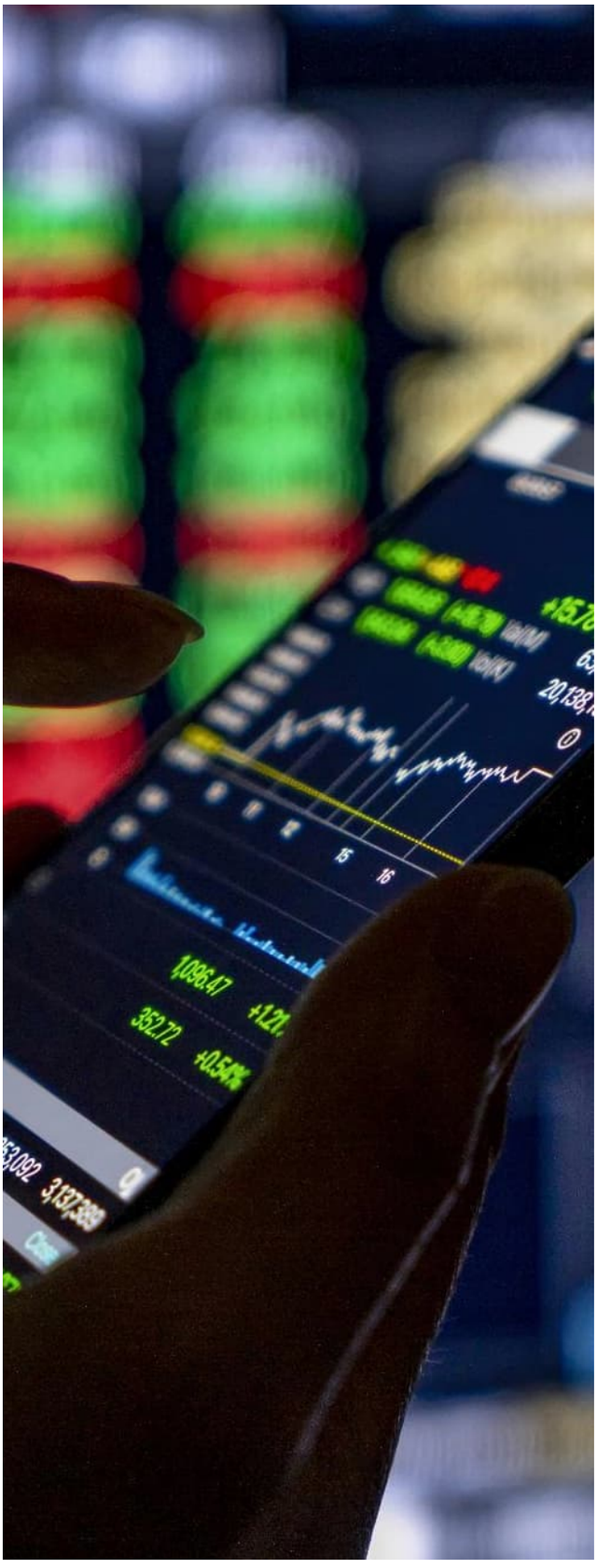
HVG Law has provided legal advice within this landscape since 2015, and HVG Law together with EY are happy to assist you with legal, strategic, business, legal, regulatory, compliance and tax challenges as well as opportunities that may arise from the world of cryptocurrencies. See below an overview of some of the topics on how HVG Law and EY can help your firm with respect to MiCA compliance. Finally, please stay tune for our upcoming client alert where we will discuss the potential impact of the proposed EU Transfer of Funds Regulation (TFR) on firms.

Tax/Legal

- Tax reporting including CARF gap analysis and implementation
- VAT support
- Support in the corporate setup of Dutch VASPs/CASPs
- Transfer pricing support and documentation
- CASP licensing and MiCA regulatory compliance
- Full regulatory and legal support, including analysis of business plans, intended activities and/or products, filings at financial regulatory authorities and implementation of business strategy

Consulting

- Strategy definition and product development (e.g., tokenisation, development of ARTs)
- Preparation and/or review of white papers
- MiCA gap analysis
- Cybersecurity, DORA and outsourcing assessments
- Compliance/Crypto-related training to staff members



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What HVG Law can do for you

We advise on all matters related to the blockchain space. From advising on and setting up Decentralized Autonomous Organizations (DAO), to advising on the applicable financial regulatory framework and from assisting with the registration of crypto-assets service providers with DNB to advising on the issuance of (security) tokens, NFTs and other cryptocurrencies.

As our track record in this space dates back to 2015, and we typically work in close collaboration with EY Tax on blockchain matters, HVG Law is ideally positioned to assist market parties in the blockchain space.

HVG LAW

About HVG Law
HVG Law LLP (HVG Law) ranks amongst the top Dutch law firms and is characterized by an entrepreneurial, innovative and solution-driven approach. With more than 150 dedicated and pragmatic lawyers, including (candidate) Civil Law Notaries, HVG Law offers high-quality, legal services in a broad and multidisciplinary context. Our lawyers are active in all legal areas and sectors relevant to business, directors, shareholders and government authorities and have knowledge of your business and your market. At our offices in Amsterdam, Rotterdam, Utrecht, Eindhoven, New York, Chicago and San Jose (i.e., Donahue & Partners LLP in the USA), we are able to offer our legal services to national and international clients.

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