

HVG Law Expert Hour - MiCA

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On the 19th of April, HVG Law and EY, in cooperation with the Blockchain Coalition Netherlands (BCNL), hosted an Expert Hour on the Markets in Crypto-Assets regulation (MiCA). During the Expert Hour HVG Law focused on answering questions submitted by participants related primarily to both the legal interpretation and the scope of MiCA¹. During the Expert Hour HVG Law also covered several practical considerations and the potential impact of MiCA. This blogpost outlines several of the Q&As discussed during the Expert Hour and also illustrates the results of our mini-survey (with approximately 50 market participants) regarding MiCA and its potential impact. However, before we dive into the Q&As and the results of the survey, we thought it helpful to set out the key MiCA take aways and considerations as a refresher for those less familiar with the MiCA framework.

Importance of MiCA

MiCA was adopted by the European Parliament on 20 April with 517 votes in favor, 38 votes against and 18 abstentions. The text of the regulation will now be published in the Official Journal by the end of June, and MiCA will formally enter into force from July 2023. This will entail radical changes in the requirements placed on players in the crypto market.

The MiCA framework is the first of its kind in the world that will apply to crypto-assets, crypto-assets issuers and crypto-assets service providers (CASPs) across all EU member states, including EEA members. The aim of the regulation is to provide clarity to companies, customers, regulators and other stakeholders that are involved in the offering/purchasing/regulating of crypto-asset related services and products. In addition, the regulation aims to ensure financial stability in markets, and protect both consumers and professional investors from various risks.

Finally, MiCA could lead to increased institutional interest and adoption. Financial institutions have long been sitting on the side lines in anticipation of regulation and legal certainty of crypto-assets. We therefore expect that the financial industry in Europe will, on a larger scale, start to execute plans to be able to offer exchange services, advisory services, custodial services and other services related to crypto-assets.

Is your business covered by the rules?

The regulations apply to the following classes of crypto-assets:

- i. Asset Reference Tokens (ART) - crypto-assets that seek to have stable value by being linked to a specific collection of several ordinary currencies (fiat), other assets/values (e.g. gold) or other cryptocurrencies.
- ii. E-Money Tokens (EMT) - centralized crypto-assets that seek to be stable by being linked to one specific fiat currency (e.g. EUR) that can typically be used as a means of payment.
- iii. Other tokens than ARTs and EMTs, such as Utility Tokens - these are other tokens with some form of utility value, for example Bitcoin, Ether etc.

¹ Note that none of the Q&As included in this blogpost can or should be construed as legal/investment advice. Also, the opinions expressed in this blogpost are solely that of the expert.

In addition to issuers and providers of tokens, rules apply to crypto-assets service providers (CASPs). CASPs are defined as a natural or legal person who offers one or more of the following services:

- a. Providing custody and administration of crypto-assets on behalf of clients
- b. Operation of a trading platform for crypto-assets
- c. Exchange of crypto-assets for funds
- d. Exchange of crypto-assets for other crypto-assets
- e. Execution of orders for crypto-assets on behalf of clients
- f. Placing of crypto-assets
- g. Reception and transmission of orders for crypto-assets on behalf of clients
- h. Providing advice on crypto-assets
- i. Providing portfolio management on crypto-assets
- j. Providing transfer services for crypto-assets on behalf of clients

Important demarcation

The rules for the aforementioned crypto-assets and related services do not, however, apply to crypto tokens which qualify as financial instruments and as a result are subject to the current financial regulatory legislation. The EU has established a framework for the regulation of financial instruments, which is set out in the MiFID (Markets in Financial Instruments Directive). 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. MiCA therefore aims to only complement and not replace the current financial regulatory framework for crypto tokens that (already) qualify as a financial instrument.

Uncertainty and interpretations - NFTs, DeFi and DAO

As a main rule, NFTs (Non-Fungible Tokens) are exempt from MiCA, but with some exceptions for larger collections of NFTs and fractionalized NFTs. It is currently unclear what the definition of a larger collection is. In addition, NFTs can qualify as a financial instrument. Therefore, each individual token's attributes must be interpreted concretely to determine whether it is subject to MiCA or other rules. We anticipate that these uncertainties in interpretation could potentially lead to both slightly different interpretations by firms and regulators and potential circumvention attempts. Therefore, further clarity in the upcoming level 2 and 3 rules are a must to harmonize and ensure a level playing field. DeFi (decentralized finance) or DAO (Decentralized Autonomous Organizations) are both not subject to MiCA provided the services are delivered in a completely decentralized manner - without a service provider as an intermediary. Here, once again, one has to assess in detail whether the attributes of the token and the structure of the individual project is completely decentralized.

Expert Hour Q&As

■ Q1: The updated version of MiCA had many additions on what was previously approved. It is highly likely that those additions will be postponed to the next iteration MiCA. Would you agree on that? Or is there a chance that the final vote of the initial version will be postponed due to new amendments and the process will start all over with approval?

■ A1: So it would appear that the version which was published with several additions was not the version on which the EP had voted on. Other than the single day delay they were no other delays.

■ Q2: What is the final text of MiCA and when will it be in force?

■ A2: At the moment of writing, it is the text which was published on 12 April. The regulation will enter into force on 20th day following its publication in the Official EU Journal. MiCA will apply 18 months after the entry into force date. Titles 3 and 4 (on ARTs and EMTs) will apply 12 months after the entry into force date (i.e. 6 months earlier).

■ Q3: To what degree are undertakings such as DAOs and other decentralised entities in/out of scope of MiCA?

■ A3: There are a few things to take in to account when answering this question. The first is that:

Further to recital 22 new (12a old), MiCA applies to “to natural and legal persons and certain other undertakings and to the crypto-asset services and activities performed, provided or controlled, directly or indirectly, by them, including when part of such activities or services is performed in a decentralised manner.”

So “certain undertakings” which carry out activities performed provided or controlled directly or indirectly (even when part of the services/activities are carried out decentral) are subject to MiCA.

This includes for example, Decentralized Finance (DeFi) and Decentralized Autonomous

Organisations operations (DAOs), provided that control of the operations is truly decentralized.

■ Q4: So, are NFTs fully out of scope of MiCA?

■ A4: MiCA does not apply to crypto-assets that are unique and not fungible with other crypto-assets, further to article 2(3) MiCA; so-called Non-Fungible Tokens (NFTs). The fractional parts of a unique and non-fungible crypto-asset should not be considered unique and non-fungible. The issuance of crypto-assets as non-fungible tokens in a large series or collection should be considered an indicator of their fungibility. The mere attribution of a unique identifier to a crypto-asset is not, in and of itself, sufficient to classify it as unique and non-fungible. The assets or rights represented should also be unique and non-fungible in order for the crypto-asset to be considered unique and non-fungible. The exclusion of crypto-assets that are unique and non-fungible from the scope of MiCA is without prejudice to the qualification of such crypto-assets as financial instruments. MiCA also applies to crypto-assets that appear to be unique and non-fungible, but whose de facto features or whose features that are linked to their de facto uses, would make them either fungible or not unique. In that regard, when assessing and classifying crypto-assets, competent authorities are requested to adopt a substance over form approach whereby the features of the crypto-asset in question determine the classification and not its designation by the issuer.

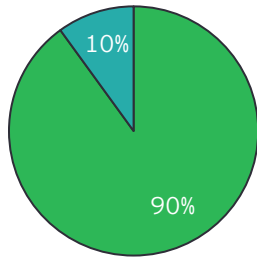
■ Q5: How long would VASP get to transition into the CASP regime?

■ A5: 18 months after the application of MiCA or until the VASP obtains or is denied the CASP license. With respect to the former, that would mean a grand total of 36 months (i.e. 18 months for the application of MiCA and an additional 18 months for the VASP to CASP transition.

- Q6: Are CASPs subject to capital requirements rules? If so, which type?
 - A6: Further to article 67 MiCA, the capital requirement is equal to an amount of at least the higher of the following:
 - (a) the amount of permanent minimum capital requirements indicated in Annex IV, depending on the type of the crypto-asset services provided (Class 1=50k; Class 2=125k; Class 3=150k); or
 - (b) one quarter of the fixed overheads of the preceding year, reviewed annually (CASP not in business for 1 year will use for this calculation, the projected fixed overheads included in their projections for the first 12 months of service provision, as submitted with their application for authorisation).
 - Q7: Is reverse solicitation still banned under MiCA?
 - A7: No, however subject to strict rules, see article 61 MiCA (old 53b). ESMA is mandated (max. 18 months after entry into force) to issue guidelines which specify the situations in which a third-country firm is deemed to solicit clients established or situated in the Union.
 - Q8: What are the main misunderstandings of MiCA?
 - A8: From my experience it is not always clear to parties what the exact scope of MiCA is. I.e. which activities are regulated and which are not.
 - Q9: Where do you see the future of DAOs?
 - A9: We see the demand/curiosity for/in DAOs increasing significantly during the last 8 months. At the moment there seems to be a lot of discussion on the legal wrapper of a DAO. For the time being MiCA does not regulate DAOs. Fully decentralized DAOs are still in principle not subject to MiCA (see also A3).
 - Q10: Has there been any changes in MiCA regarding asset backed tokens that currently constitute as securities?
 - A10: The classification of a crypto token as a financial instrument depended & still depends 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). 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 -tokens may be considered transferrable securities if they meet the criteria set out in the MiFID definition. If the specific crypto token does not meet the MiFID criteria then one would need to assess whether the crypto token qualifies as one of the MiCA regulated crypto-assets. Other crypto-assets, such as stablecoins, may (theoretically) prior to the enforcement of MiCA, 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.
 - Q11: What is the added value of HVG Law?
 - A11: Good question, in addition to our deep knowledge and experience with financial law and blockchain/crypto applications thereof, we work very closely on projects with our EY and EY law colleagues.
- Feel free to get in touch if you want to discuss MiCA, the interpretation of the rules or other areas related to crypto-assets e.g. business development, strategy, risk analyses, AML/KYC, smart contract reviews, regulatory, tax or VAT. Finally, we highly recommend that firms assess as early as possible whether and/or how MiCA can affect their business models.

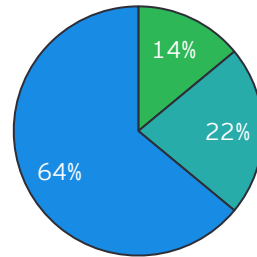
Mini-survey impact of MiCA

Do you think that the introduction of MiCA in general is a positive step for the sector?



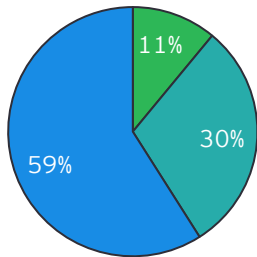
■ Yes ■ No ■ Not sure

Do you believe that the crypto-asset services outlined in MiCA are future proof (i.e. technology neutral)?



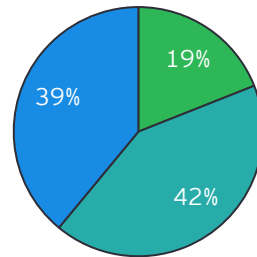
■ Yes ■ No ■ Not sure

Does the introduction of MiCA overburden your current crypto-related business model?



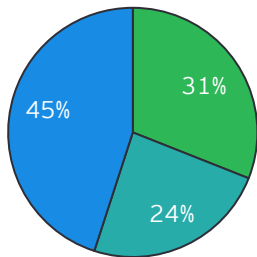
■ Yes ■ No ■ Not sure

Is your firm considering issuing crypto asset tokens (i.e. ARTs/EMTs/UTs) under MiCA in the foreseeable future?



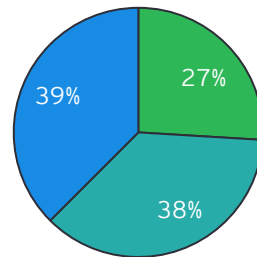
■ Yes ■ No ■ Not sure

Is it clear to you what the newly introduced crypto-asset services entail?



■ Yes ■ No ■ Not sure

With the introduction of MiCA, is your firm considering to apply for a CASP license (provided your firm does not already have a VASP license)?



■ Yes ■ No ■ Not sure

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