Bird & Bird

Road to MiCAR: The European Crypto-assets Regulation

The European Union is working on a Regulation on Markets in Crypto-assets (MiCAR).

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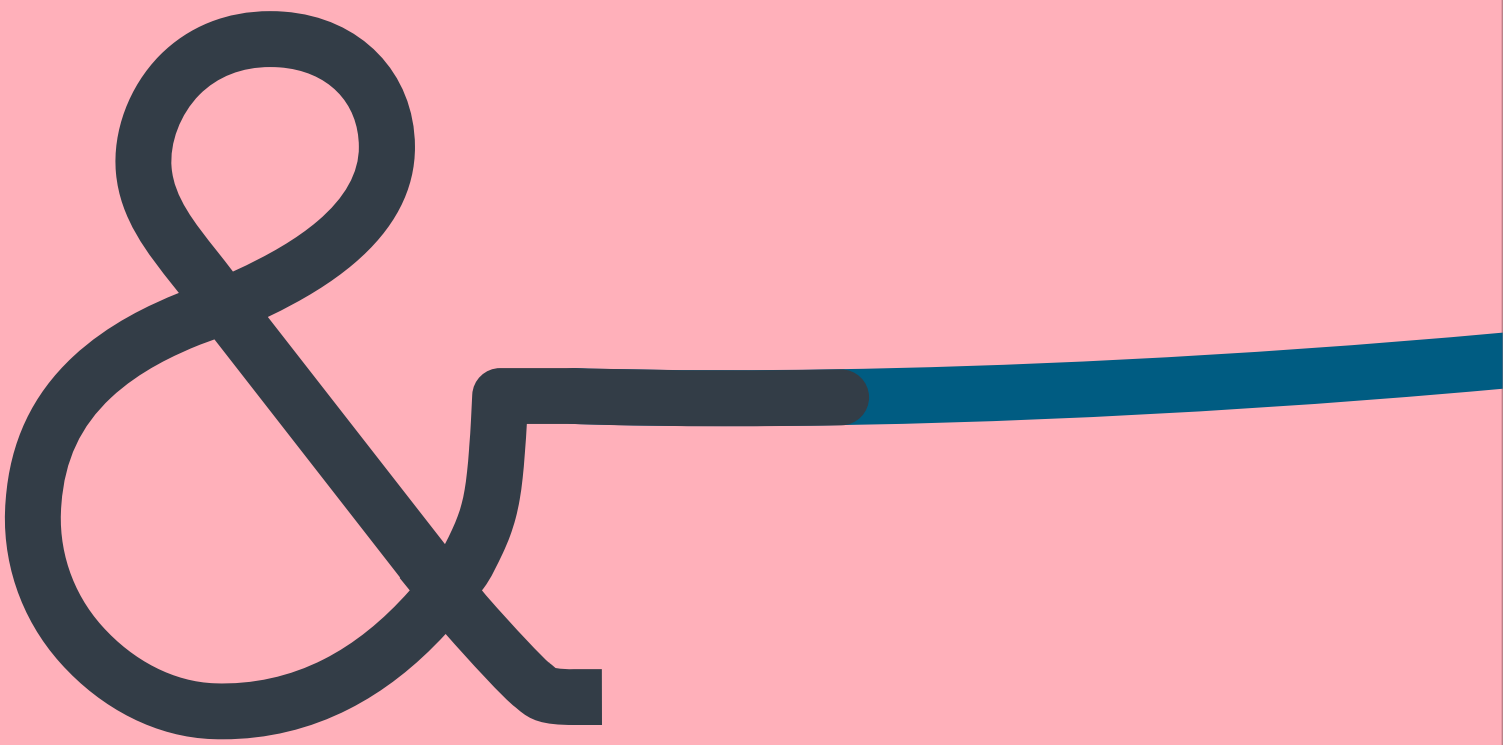

Contents

This article serves to accompany the introduction of MiCAR in Europe: the Road to MiCAR. This article will therefore be continually supplemented and updated up to the moment of introduction of MiCAR. The article includes input from Bird & Bird offices in different countries, at this stage including Denmark, Germany, Italy and Spain. Currently, the article covers the following topics:

1. Introduction to MiCAR

The regulation of crypto assets and related services is still not treated uniformly in the European Union and resembles more a patchwork of regulatory fragmentation.

Although the fifth Anti-Money Laundering Directive (AMLD5) also covers certain crypto assets under the term "virtual currencies", it does not provide a harmonised approach. As a result of the implementation of the AMLD5, each Member State has created its own regulatory regime for transactions related to "virtual currencies" or crypto assets. This problem is addressed by the European Commission's proposal for the Regulation Markets in Crypto-assets (abbreviated as MiCAR), aiming at creating an EU framework for crypto-assets that fall outside the scope of existing EU financial regulation. It is currently expected that MiCAR will come into force in 2022 and will be directly applicable in all Member States after an 18-month transition period. This means that a harmonised set of rules for products and services related to crypto-assets can be expected throughout the European Union in 2024.

a. The current patchwork of regulatory fragmentation

Germany had already gone ahead with the implementation of the fifth Anti-Money Laundering Directive (AMLD5) and had created the crypto custody business as a new regulated financial service. In addition, Germany enacted an Electronic Securities Act (eWpG), which also covers the crypto sector and offers further opportunities.

Denmark has transposed AMLD5 and included providers of exchange services between virtual currencies and fiat currencies, providers of virtual wallets, providers of exchanges services between virtual currencies, providers of virtual currency transfers and issuers if virtual currencies.

Italy has – as part of the transposition of the EU Anti-Money Laundering Directives – also issued a decree (Decree of the Ministry of Economy and Finance of 13 January 2022) setting out the procedures and timing by which providers of services related to the use of virtual currency and providers of digital wallet services intending to perform services related to the use of virtual currency in the territory of the Italian Republic are required to report their transactions in Italy.

Spain has likewise transposed the AMLD5 regulation by means of Royal Decree-Law 7/2021, of 27 April, which introduced several amendments to Law 10/2010, of 28 April, on anti-money laundering and terrorist financing ("Spanish AML Act"), for the purposes of aligning its content to the provisions set forth under AMLD5.

The most relevant amendments resulting from the transposition are:

i. the incorporation of exchanges of virtual currency for fiat currency and custodians of electronic crypto-wallets as new "obliged entities" under the Spanish anti money-laundering act; and
ii. registration duties, imposed on such new "obliged entities", which shall now register within the special register held by the Bank of Spain (the Spanish national competent authority for supervising the provision of financial services).

b. The proposal

In September 2020, the European Union further pursued the Digital Finance Strategy with the MiCAR proposal. Both the opportunities and the risks are best addressed in a common regulation for all Member States.

The MiCAR proposal aims to regulate these issues at EU level and create legal certainty across Europe. This would enable a larger number of investors to be active in this area and to use distributed ledger technology (DLT). At the same time, innovation and development are to be promoted. The MiCAR proposal should ensure that financial stability in the EU is guaranteed in the process.

In November 2021, the European Council adopted its position and published its negotiation mandate. On 14 March 2022 the Committee on Economic and Monetary Affairs of the European Parliament ("ECON Committee") voted on a draft of the MiCAR. The legislative process continues.

c. Overview

The content of the MiCAR proposal can be divided into three sections:

- The authorisation requirements for issuers of crypto-assets and the corresponding obligations for the types of tokens covered by the regulation (asset-referenced tokens, e-money tokens and, as a catch-all, crypto-assets).

- The second section covers the authorisation requirements for providers of services related to crypto-assets.
- The third section deals with the competent authorities and their competences.

d. Objective: What is being regulated?

According to the current proposal, MiCAR is to apply to all persons who want to issue crypto-assets or provide services related to crypto-assets in the European Union. The MiCAR proposal is intended to lay down uniform rules on transparency and disclosure requirements for the issuance, offer to the public and the admission to trading of crypto-assets. In addition, there are rules on the authorisation and supervision of crypto-asset service providers and their issuers. The main focus lies with the issuers of asset-referenced tokens and e-money tokens. The Regulation intends to regulate the operation, organisation and governance of issuers of asset-referenced tokens and e-money tokens and crypto-asset service providers. There will also be investor protection rules for the issuance, trading, exchange and custody of crypto-assets. In addition, measures to prevent market abuse are to be included in the Regulation to ensure the integrity of the crypto-assets markets.

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2. Crypto-assets

a. What is covered?

MiCAR is designed to complement existing legislation. It is intended to cover companies that issue crypto-assets or provide services in relation to crypto-assets. Explicitly excluded from the scope of application are crypto-assets that are already covered by other legislation, such as financial instruments under MiFID II, deposits under the Deposit Guarantee Scheme Directive or securitisations under the Securitisation Regulation. The first draft was also supposed to exclude e-money according to the E-Money Directive (as far as it does not concern e-money tokens) from the scope of application, but this is no longer provided for in the current version.

In addition, the regulation is not to apply to certain organisations. The exemptions also include, among other things, when a company only provides crypto-asset services to group companies. In the original draft of September 2020 credit institutions and investment firms were exempted from certain provisions of MiCAR, but these institutions are now allowed to provide services relating to crypto-assets under their CRD/MiFID authorisation if they have notified this to the supervisory authority.

b. Types of crypto-assets under the MiCAR

The proposal of MiCAR defines a crypto-asset as the digital representation of a value or right that can be transmitted and stored electronically and uses a DLT. The proposed MiCAR divides crypto-assets into the following subcategories:

- 'Asset-referenced tokens' (ARTs): These are crypto-assets that are intended to serve as a medium of exchange, without being e-money, and that are intended to have a stable value by referencing fiat currencies, commodities or other cryptocurrencies. Stablecoins in particular should be considered here.
- 'Electronic money token' or 'e-money token': These are crypto-assets that are intended to serve as a medium of exchange and are denominated in a fiat currency.
- 'Utility tokens': These are crypto-assets which are only intended to provide access to a good or a service supplied by the issuer of that token.

Asset-referenced tokens and e-money tokens may each be classified as significant asset-referenced tokens or significant e-money tokens under the Regulation. In this case, issuers are subject to more extensive requirements. According to the European Commission (EC), 'utility tokens' have non-financial purposes related to the operation of a digital platform and digital services and should be considered as a specific type of crypto-assets.

Germany introduced a definition of crypto assets in the German Banking Act (*Kreditwesengesetz - KWG*) when implementing AMLD5. The definition of crypto-assets from the MiCAR is, however, not congruent with the term of the German Banking Act (*Kreditwesengesetz - KWG*), so the German market is expected to adapt to the new developments in crypto legislation.

Spain, on its side, has included a definition of crypto-asset by means of article 3 (e) of the recently published Circular 1/2022, of 10 January, related to the marketing of crypto assets as investment assets (the "Circular"), published by the National Securities and Markets Commission ("CNMV") on February 2022, which is fully aligned with the definition provided under MiCAR. References to the definition of "virtual currency" were also included in the Spanish AML Act as a result of AMLD5 transposition, which may be amended from time to time in order to align such definition to those provided under MiCAR and the Circular.

c. What is not a crypto-asset but DLT based (examples)

MiCAR does not cover everything that is based on a distributed ledger technology (DLT). According to the current status, crypto-assets that are unique and not fungible with other crypto-assets may also fall outside the scope. This is likely to be the case for non-fungible tokens (NFTs). We will explore this question further in the course of amending this document.

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3. Offering/issuance of crypto-assets

The MiCAR is intended to establish rules for the offering/issuance and marketing of crypto-assets by their offerors/issuers. Here, a distinction is made between asset-based tokens and e-money tokens, in contrast to other crypto-assets.

a. Offer of (other) crypto-assets, that aren't asset-referenced tokens or e-money tokens, to the public

For the (other) crypto-assets that are not asset-referenced tokens or e-money tokens, the offeror must prepare, publish and notify the competent authority of a white paper. The whitepaper must, among other things, describe the essential characteristics of the crypto-asset and present the associated risks. There is a kind of prospectus obligation, so to speak. The offeror must also be a legal person and meet certain conduct requirements.

There are exceptions to these rules for, among other things, free offers of crypto-assets or for utility tokens that can effectively be exchanged for (existing) goods or services.

Then, there is also a specific exception on the white paper. This requirement no longer applies in case an offer is made to fewer than 150 persons per Member State; or when turnover of the offer does not exceed EUR 1 000 000 within 12 months; or an offer is solely addressed to and can only be held by qualified investors. In these cases, however, the offeror must still be a legal person and meet any conduct requirements.

b. Offer from asset-referenced tokens, to the public

Stricter requirements are placed on the issuance of asset-referenced tokens. The offeror must meet certain requirements and must be authorised by the competent authority. Credit institutions do not need a special authorisation, but they must comply with certain rules. There is also a kind of prospectus requirement for asset-referenced tokens. However, the white paper must not only be published, it must also be approved by the competent authority.

The general requirements for the issuer of asset-referenced tokens include that the issuer must be a legal person established within the EU. Certain conduct requirements apply to the offeror. Offerors must also meet the capital requirement of at least EUR 350 000 own funds. An authorisation as an offeror to issue asset-referenced tokens shall be valid for the entire EU. Supervision, however, remains with the competent authority of the EU Member State in which the offeror is domiciled. If an offeror issues significant asset-referenced tokens, it will be subject to higher requirements. Supervision will then be carried out at the European level by the European Banking Authority (EBA).

The rules won't apply if the asset-referenced tokens are only distributed to and can only be held by qualified investors or the issued amount of asset-referenced tokens does not exceed EUR 5 000 000 over a 12-month period. While the original proposal was not intended to cover stablecoins, which obtain their value through an algorithm that determines the value through the number of tokens based on supply and demand, the latest version seems to cover them.

c. Issuance of e-money tokens

MiCAR will have specific requirements on the offer of e-money tokens. It is envisaged that e-money tokens may only be issued by credit institutions and electronic money institutions. A white paper must also be drafted for e-money tokens and notified to the competent authority. Incidentally, a large number of regulations from the E-Money Directive also apply here, for example, the prohibition of the granting of interest.

The rule that e-money tokens may only be issued by credit institutions and electronic money institutions does not apply if the issuer is exempt under the E-Money Directive or if an exemption on the notion of e-money under the E-Money Directive applies (e.g. payment instruments with limited use: Limited Range or Limited Network).

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4. Authorisation and operating conditions for Crypto-Asset Service providers

New legislation always brings a certain amount of uncertainty to the market. It is therefore important to prepare now already for the changes in MiCAR will bring. Questions arise as to what will happen to crypto undertakings already authorised under national law, once MiCAR comes into force. How will they be treated under the proposed Regulation? And does it make sense to still acquire an authorisation under national law before MiCAR comes into force?

a. Authorisation and operating conditions of crypto-asset service providers

Also the provision of services of crypto-assets will be regulated. Only legal persons that are established in the EU and have received the relevant authorisation may provide these services. The authorisation is to be valid for the entire EU (so-called passporting). This offers a decisive advantage compared to the currently applicable individual national rules, which the undertakings have to examine with a lot of effort on a separate basis. In addition to the capital requirements, depending on the type of service, there are also requirements for the management body (good repute and possess sufficient knowledge, skills and experience, committing sufficient time). The shareholders of the service providers must also have good repute.

The service providers also have obligations towards conflicts of interest, information obligations and provisions on outsourcing. Depending on the activity offered by the service provider, further requirements apply.

b. Current status in some EU jurisdictions

i. Germany

Under the current national legal situation, Germany follows a strict approach compared to the rest of the European Union in an international comparison: crypto-assets are recorded as financial instruments. A MiFID authorisation is required for the provision of crypto-asset services such as the brokerage of tokens; a separate crypto-asset custody license is required for the provision of wallet services. The corresponding authorisation requirements of MiFID II (Directive 2014/65/EU) were implemented in Germany in the German Banking Act (*Kreditwesengesetz - KWG*) and the Investment Firm Act (*Wertpapierinstitutsgesetz - WpIG*) and were also made applicable to crypto-asset services for Germany. The authorisation is granted by the Federal Financial Supervisory Authority (*BaFin*).

However, this strict approach may have its advantages. On the one hand, Germany already offers a clear legal framework for crypto-asset business. On the other hand, service providers with MiFID authorisations benefit from grandfathering/transitional provisions under the current MiCAR proposal. In this way, the advantages of the current German regulatory regime on crypto-assets can be optimally used to stay 'ahead' in the implementation of MiCAR.

ii. Denmark

Specific regulation of crypto-assets except for AML related regulation has not at this stage been introduced in Denmark. The Danish Financial Supervisory Authority (*Danish FSA)* has – also triggered by MiCAR - established a crypto-asset focus group with the aim of supporting an efficient supervision on the crypto-asset area. The focus group will be contributing with input on guidance and risk assessments and generally supporting the Danish FSA in this supervision of crypto-assets.

iii. Italy

The exercise on the territory of the Italian Republic of services relating to the use of virtual currency and digital portfolio services is reserved to persons registered in the special section of the section of the register kept by the competent authority (*Organismo degli Agenti e Mediatori – OAM*), a public body for the management of lists of agents in financial activity and credit brokers. Registration in the special section of the register is subject to the possession of certain requirements, which are verified on an ongoing basis by the OAM.

iv. Spain

As a result of local transposition of AMLD 5 in Spain, crypto exchanges and wallet providers who (i) intend to carry out their business activity in Spain; (ii) are established in Spanish soil; or (iii) whose base, direction or management of the activity related to crypto-assets is in Spain, are obliged to register within a special register held by the Bank of Spain (Spanish NCA for supervising banking services).

Non-compliance with registration duties is considered a severe infraction and may be sanctioned with fines up to 10% of the total turnover or 10M Euro, whatever of both amounts is higher.

The registration process is straightforward and involves submitting corporate information from the provider, which shall evidence, at the discretion of the Bank of Spain, the honourability of its managers/directors and the anti-money laundering policies and processes that the provider has put in place in order to comply with its AML obligations, which have to pass through a strict filter to be deemed appropriate.

Additionally, it must be noted that CNMV's Circular, among other issues, regulates advertising of crypto-assets targeted to Spanish investors when it is carried out by providers of services over crypto-assets. Key obligations that may apply to advertising campaigns carried out by such providers under the Circular include:

- adapting the campaign's content to ensure that it is transparent to investors (i.e., by including certain disclaimers or warnings on the risks related to cryptoassets);
- prior notification to the CNMV where a campaign is targeted to a massive public (i.e., +100,000 investors); or
- keeping record of the details of the current and past campaigns.

c. Grandfathering/transitional provisions of MiCAR

Institutions with a MiFID authorisation will be able to continue to conduct business under MiCAR without having to obtain a separate authorisation under MiCAR where they only provide one or several crypto-asset services equivalent to the investment services and activities for which they are authorised under MiFID II. The transition to MiCAR will also be easier for e-money institutions than for new market participants.

d. E-money institutions

A grandfathering process will be available to e-money institutions, under which a simplified procedure for obtaining an authorisation will be offered rather than having to undergo the full authorisation process. The details of the simplified procedure are not yet specified in the current MiCAR proposal. However, it is intended to waive such documents in the authorisation procedure that are already known to the competent authority.

e. MiFID firms

Institutions that are authorised under MiFID II (such as investment firms) are not subject to the authorisation provisions under MiCAR when providing crypto-asset services. These institutions may continue to provide services they have previously provided in relation to financial instruments under MiFID II also with regard to crypto-assets without any further authorisation requirement.

5. Powers of NCAs, EBA and ESMA

The task of supervising the issuers of significant asset-referenced tokens is assigned to the EBA, once such asset-referenced tokens have been classified as significant.

Issuers of significant e-money tokens are subject to dual supervision by both national competent authorities (NCAs) and the EBA given the risks they can pose to financial stability.

European Securities and Markets Authority (ESMA) should establish a register of crypto-asset service providers, which should include information on the entities authorised to provide those services across the European Union. That register should also include the crypto-asset white papers notified to competent authorities and published by issuers of crypto-assets.

Any other rules concerning the application of MiCAR is under the power of the national competent authorities.

6. Conclusion

After a first review of the MiCAR proposal, it can be said that the proposed rules provide a clear regulatory framework for the European crypto sector. This proposal can prevent national rules from complicating any further development of the crypto sector. The fact that a regulation and not a directive was chosen as the means of legislation for this may be surprising at first glance, but with this, "gold-plating" from Member States is prevented. This means that this area is then even more harmonised than other financial services.

Given the advantages that MiFID institutions benefit under MiCAR, it is an attractive option for new market participants to apply now for an authorisation as a MiFID institution (e.g. in Germany where a MiFID license is already now required for equivalent services in crypto). When MiCAR comes into force, these institutions will not be exposed to the uncertainties that a new implementation of the law inevitably entails. A simplified authorisation procedure also awaits e-money institutions that have already been authorised, which is advantageous. This is because providers of crypto-asset services (from unregulated EU countries in particular) face higher costs that may result from obtaining the authorisations and the establishment of suitable structures to meet the requirements of MiCAR. An early establishment of such an infrastructure under an already established legal framework therefore lends itself as an advantage.

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