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**Regulating Crypto-Assets & DLT in the EU:
The Digital Finance Package & MiCA**



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Regulation of crypto in EU: a slow start!

Bitcoin's genesis block: created on, or shortly after, 3 January 2009

Case C-264/14, *Hedqvist*, ECLI:EU:C:2015:718: Bitcoin as 'virtual currency'?

Early regulatory pronouncements in EU

ECB Virtual Asset report, October 2012: VAs' anonymity could present AML risks

ECB Opinion on VAs, July 2014: risks to financial integrity, especially due to AML risks

EBA / ESMA warnings on risks

ESMA and EBA reports, 9 January 2019:

majority of crypto-assets qualify as financial instruments under MiFID II;

others may fall within the regulatory scope of the E-Money Directive and/or PSD II

AML initiatives, in the context of FATF recommendations/guidance

Commission report on AML risks, June 2017, COM(2017) 340 final

5th AML Directive, June 2018, fully effective on 10 January 2020:

extension of scope of AML regime to virtual currency exchanges & custodian wallet providers (included in list of obliged entities)

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Current EU legislative initiatives on DLT & crypto-assets

Digital Finance package, 24 Sep 2020

MiCA

DLT Pilot Regime Regulation (Regulation (EU) 2022/858)

DORA

FinTech amending directive

AML package, 20 July 2021

AML Authority Regulation

6th AML Directive

AML-CTF Regulation

Funds Transfer Amending Regulation (Regulation on information accompanying transfers of funds and certain crypto-assets)

Preparatory work on draft Digital Euro Regulation

Regulation on Markets in Crypto-Assets (MiCA)

Single, relatively robust EU regulatory framework for crypto-assets

Incentivized by Libra announcement

Aims to replace inconsistent national approaches (where they exist) with a comprehensive and consistent Union-wide regulatory framework

Legislative process

Proposed by the Commission in September 2020 as part of the Digital Finance package

Close relation to latest AML package

Trilogue work completed in June 2022; final Council text submitted on 5 October, approved by EP ECON on 10 October

Vote in EP Plenary Session pending (now expected in early 2023)

New rules likely to become binding on relevant legal and natural persons in 2024 (12-18 months after MiCA's entry into force)

MiCA in global context

Increased global concern with crypto-assets

Especially since the announcement of the Libra/Diem project in 2019:
global stablecoins as threat to monetary sovereignty and financial stability

Incentives for

- (a) bringing crypto within the regulatory net and
- (b) introducing CBDCs

FSB emphasis on regulation of global stablecoins and other crypto-assets

11 July 2022: FSB statement on potential risks & threats from crypto-assets;
concern about lack of conformance with existing standards, applicable rules & regulations

11 October 2022: Consultative documents on:

'Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets'; and
'Review of FSB High-level Recommendations of the Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements'

Objectives & general approach

Objectives go beyond AML

By establishing legal clarity & certainty & a single licensing system, it supports digital innovation, adoption of DLT-based solutions by traditional financial firms, fair competition, market integration, & the scaling up of digital finance operations

Consumer/investor protection

Market integrity in the crypto-asset trading markets

Financial stability, containment of monetary policy risks and preservation of monetary sovereignty (especially in relation to stablecoins)

Comprehensive framework for activities in crypto-assets

MiCA tends to prioritize transparency, safety, market integrity, protection for retail holders of crypto-assets, as well as equivalent rules for equivalent functions, over experimentation and growth-based arguments for light-touch regulation

Uniquely comprehensive, it is likely to operate as global standard ('Brussels effect')

Still, additional legislative initiatives should be expected as experience and understanding grow (eg, in relation to crypto lending)

Scope, definitions & classification of crypto-assets

MiCA applies to (a) **issuers or offerors to the public** of crypto-assets, and (b) providers of services related to crypto-assets ('**CASPs**')

'Crypto-asset': broad definition

Digital representation of a value or a right which may be transferred and stored electronically, using DLT or similar technology

Identification of three specific subcategories

- '**E-money token**': purports to maintain a stable value by referencing to the value of one official currency
- '**Asset-referenced token**': not an e-money token, purports to maintain a stable value by referencing to any other value or right or a combination thereof, including one or more official currencies
- 'Utility token': crypto-asset which is only intended to provide access to a good or a service supplied by the issuer of that token

MiCA's norms do not apply to (a) NFTs; and (b) tokens qualifying as financial instruments, deposits, etc, under other EU financial services legislation

Key provisions

Disclosure requirements for issuance & admission to trading of crypto-assets: requirement of white paper

Authorization of, and operating conditions on, issuers of asset-referenced tokens and electronic money tokens

Authorization of, and operating conditions on, on CASPs

Consumer protection rules: protections for holders of crypto-assets and clients of crypto-asset service providers

Market-abuse regime for publicly traded crypto-assets, modelled on MAR

Regulatory vetting of changes of control (qualifying holdings) in CASPs and issuers of asset-referenced tokens

Supervisory powers and sanctioning of infringements: heavy fines

Requirements on offerors

Offerors to the public / persons seeking admission to trading in the EU must notify to the home NCA and publish in advance a 'white paper'

Mandatory disclosures on

- the issuer, offeror, operator of trading platform;
- the project to be carried out, including past & future milestones (business plan);
- the rights and obligations of holders, including any restrictions on transferability;
- the underlying technology used for such assets;
- related risks;
- adverse environmental and climate-related impact of the consensus mechanism;
- boilerplate on lack of coverage by DGS or investor compensation scheme

Additional marketing communications must be labelled as such, be consistent with the contents of the white paper, and be fair, clear, and not misleading

Exemptions: if offering to fewer than 150 persons per MS, or total consideration does not exceed €1 ml, or offering exclusively addressed to qualified investors

Crypto-assets issued prior to the application of MiCA: exempted/grandfathered

Right of withdrawal of retail holders (except for ARTs & EMTs) within 14 days

Regulation of asset-reference and e-money tokens

More extensive requirements

- Disclosure of various policies in the white paper
- Operational, organisational, and governance requirements
- Vetting of key management
- Safeguarding of reserves

Issuers of **asset-referenced tokens** (including **algorithmic stablecoins**)

- Should have registered office in the Union
- Prior regulatory approval of white paper / marketing communications
- Prohibition on granting interest on tokens
- Robust governance arrangements, including a clear organizational structure and effective processes to identify, manage, monitor, report risks

Additional restrictions on (global) stablecoins

- See now MiCA, final Council text, Arts 19b (on ARTs used widely as a means of exchange) and 39-41, 50-52 (on 'significant' ARTs/EMTs)

Crypto-asset service providers (CASPs)

MiCA applies to CASPs providing services to EU residents

The regulatory regime covers the provision of a wide range of services

- 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

Authorisation of CASPs

CASP authorization

Regulated financial institution (credit institution, investment firm, etc) also offering relevant crypto services following notification to its home NCA, or Entity specially authorized by relevant NCA under MiCA

CASPs must have local presence in home MS / EU

Registered office in MS where they have substantive crypto activities

Place of effective management (where key management and commercial decisions are taken) in the EU

At least one of the directors resident in the EU

Home MS authorization: valid across EU ('passport')

Third-country CASPs may provide services only at the initiative of a client based in the EU ('reverse solicitation')

Ongoing obligations of CASPs

Extensive ongoing obligations

- Conduct of business: act honestly, fairly, professionally in best interests of clients
- Disclosure/transparency, including on costs/pricing and risks relating to the services
- Prudential requirements (regulatory capital and/or insurance)
- Safekeeping of clients' crypto-assets and funds, including segregation
- Governance, including fit & proper tests for management and policies/ procedures for compliance, AML, continuity of services, data security
- Recordkeeping and regulatory reporting
- Complaint handling procedures
- Preventing and managing conflicts of interest
- Outsourcing requirements
- Planning for orderly wind-down
- Specific requirements for custody and administration of crypto- assets; transfer services for crypto-assets; and trading platforms

DLT Pilot regime

Regulatory 'sandbox' for DLT-based market infrastructures

Entered into force on 23 June 2022; will start applying on 23 March 2023

Aim: to remove regulatory obstacles to the implementation of DLT in financial market infrastructures and enable the trading and settlement for 'tokenised' securities, allow market participants and regulators to gain experience

DLT MIs: existing CSDs/investment firms or new entrants, operating as multilateral trading facilities, trading & settlement systems, or settlement systems

DLT MIs can request limited exemptions from requirements in EU legislation (MiFID II, CSDR), if they comply with certain conditions and any compensatory measures requested by the relevant NCA

Possibility of exemption allowing direct access to retail investors!

Limits on size and liquidity of DLT financial instruments

See also ESMA, 'Report on the DLT Pilot Regime' (27 September 2022)

AML package

The legislative package of July 2021 aligns the AML framework to the MiCA regime in so far as crypto-assets are concerned

AML Regulation

Covers transactions in crypto-assets as defined in MiCA Regulation;
the definition of 'virtual currencies' in the 5th AML Directive is abandoned
Includes CASPs to its list obliged entities, subject to customer due diligence and reporting obligations

Funds Transfer Amending Regulation

Implements FATF's 'travel rule' in the EU
Extends to CASPs the obligation of payment service providers to accompany transfers of funds with information on the payer and payee
Expected to come into force in mid-2024

Thank you for your attention!

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