EU RegCORE – Background Briefing

Mastering MiCAR – The EU's Markets in Crypto-Assets Regulation (MiCAR) – how to apply and comply

July 2023

pwc

Financial Services

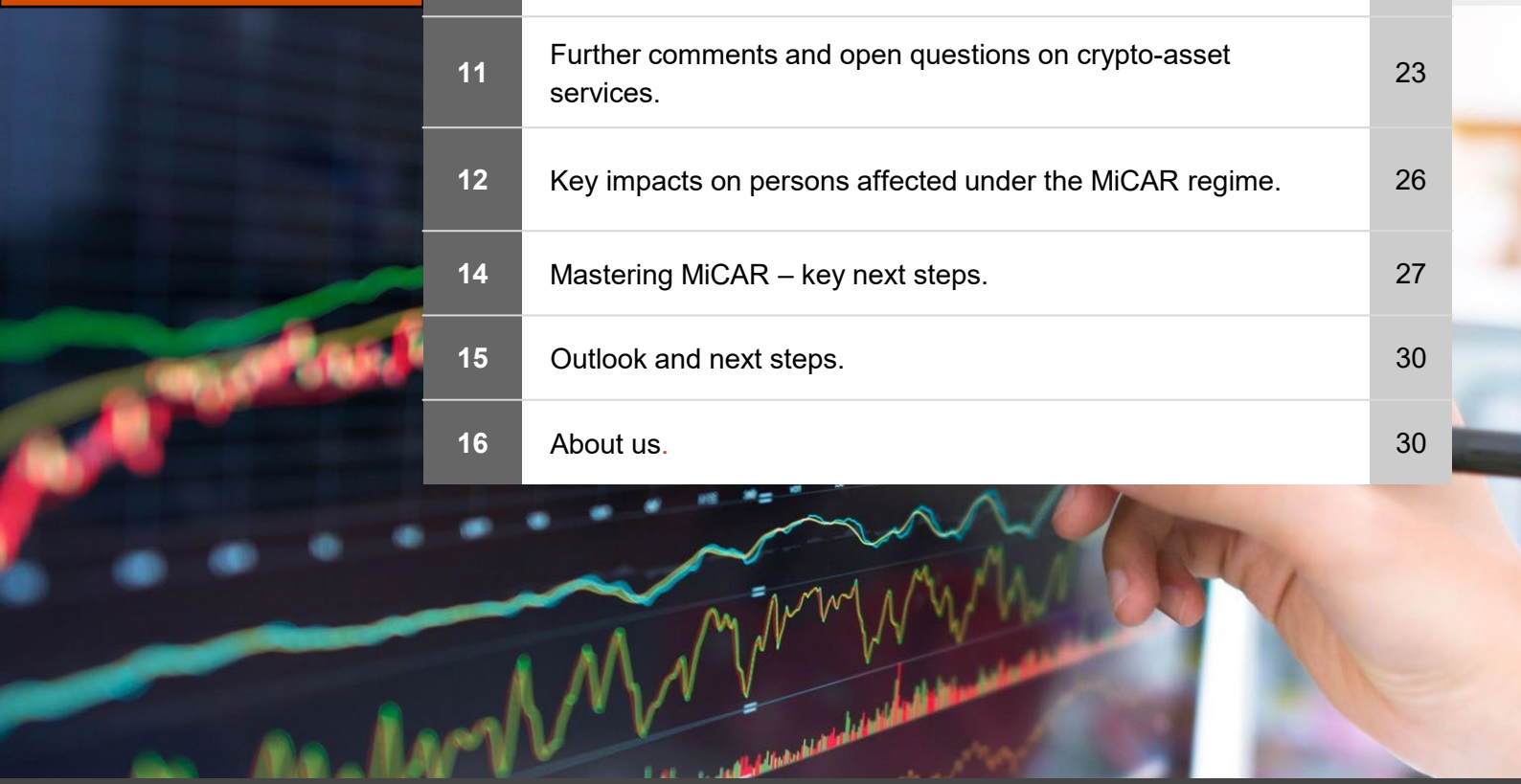
Mastering MiCAR – The EU's Markets in Crypto-Assets Regulation – how to apply and comply

Dr. Michael Huertas
Tel.: +49 160 973 757-60
michael.huertas@pwc.com

Contact EU RegCORE Team
de_regcore@pwc.com

Andreas Traum
Tel.: +49 30 263 638- 20
andreas.traum@pwc.com

Table of Contents



Financial Services

QuickTake

The EU's long-awaited Markets in Crypto-Assets Regulation (**MiCAR**) was published in the EU's Official Journal on 9 June 2023 and entered into force on 30 June 2023. Some provisions begin to apply already from 30 June 2024 with the remainder applying from December 2024 onwards.[1] Rulemaking however will not stop there. MiCAR paves the regulatory road with EU-level authorities publishing numerous further EU-wide applicable technical standards – implementing technical standards (**ITS**) and regulatory technical standards (**RTS**) – as stipulated under MiCAR or as required under the "traditional financial services" legislation amended by MiCAR. EU-level authorities along with national competent authorities (**NCA**s) are expected to publish a breadth of supervisory guidance and expectations as well as NCA-specific items such as MiCAR license application related forms and requirements. Further details on (draft) ITS and RTS are available in this series of Client Alerts and Background Briefings from PwC Legal's EU RegCORE microsite.

MiCAR creates a comprehensive regulatory and supervisory framework for previously mainly unregulated crypto-assets. The adoption of MiCAR concludes a successful legislative process introducing a new chapter into the EU's Single Rulebook and is applicable to crypto-asset services providers (**CASP**s) and crypto-asset issuers (**CAI**s) operating in or across the EU.[2] MiCAR thus replaces a patchwork of individual Member States' national frameworks on the regulation of crypto-assets and aims to strike a fair balance between addressing different levels of risk posed by each type of crypto-asset and the need to foster financial innovation.

Jointly with the EU's Regulation for a pilot distributed ledger technology market infrastructure regime and related sandbox structure[3] (the **DLT Pilot Regime** or **PDMIR**), MiCAR marks a major milestone in the European Commission's (**Commission**) delivery of its Digital Finance Package roadmap.[4] As such, MiCAR also reflects further progress in delivering the EU's efforts to build a Capital Markets Union (**CMU**). Although this long-term European project is still facing headwinds on a lot of fronts,[5] given the institutional constraints at EU level, the relatively early introduction of MiCAR signals confidence that CMU can, and is likely to continue to, be further nudged through top-down EU legislation in the form of EU Regulations as opposed to Directives. This newest addition to the EU's Single Rulebook being introduced in the form of a Regulation, that is achieving maximum harmonisation of substantive law across the EU, speaks for itself.

The regulated activity and services governed by MiCAR are largely similar to those falling under the currently applicable body of EU financial regulation (notably MiFID II as amended by IFR/IFD) and trigger a licensing requirement both for CASPs and CAIs. In general, however, most business activity related to crypto-assets in the EU is likely to fall under MiCAR and therefore requires authorisation under this new regime. Other activity may in future be included under RTS published pursuant to MiCAR and/or due to other forthcoming EU legislative and regulatory requirements in policymakers' pipeline.

In the context of regulatory simplification, CRR credit institutions as well as authorised MiFID/IFR/IFD investment firms may benefit from a simplified procedure in that they are not required to obtain a separate authorisation but must simply notify the applicable NCA of the intention to provide these services in scope of MiCAR to "top-up" their activity.

MiCAR's provisions aim to be technology neutral as well as asset class and jurisdiction agnostic. MiCAR therefore allows for the use of both permission-less[6] and permission-based[7] distributed ledger technology (**DLT**).[8] Crucially however, MiCAR defines which types of digital assets qualify as "financial instruments",which are governed by the existing financial services regulatory regime, as amended, and those tokens that qualify as "crypto-assets"[9] and which are governed by MiCAR. This distinction will be further supplemented by more specific guidance in forthcoming RTS.[10]

This Background Briefing expands on an earlier Client Alert from PwC Legal's EU RegCORE and provides an overview of (a) what the MiCAR regime (currently) covers, (b) what it (presently) does not and (c) what those persons that are either CAIs or CASPs should do to apply and comply with this new regulatory and supervisory framework and what challenges as well as opportunities may follow. Notably, the EU is still yet to finalise its regulatory capital rules on crypto-assets (see further coverage from our EU RegCORE on this). Accordingly, this Background Briefing also reflects on recent policy recommendations published by the European Systemic Risk Board (**ESRB**) and the International Organisation of Securities Commissions (**IOSCO**) as a reflection of global developments and indication for the direction in which the regulatory policy and rulemaking road is likely to head.

[1] Available here.

[2] Article 2(1) (*Scope*) MiCAR goes further to state that MiCAR applies to "natural and legal persons and certain other undertakings that are engaged in the issuance, offer to the public and admission to trading of crypto-assets or that provide services to related to crypto-assets…" in the EU. This thus conceptually also applies to decentralised autonomous organisations (**DAO**s).

[3] Available here.

[4] first published in 2020, which from 23 March 2023 established a regulatory framework for facilitating the implementation of DLT and crypto-assets in the European financial services sector

[5] these include, inter alia, property law, insolvency law and tax law.

[6] Refers to a DLT network in which anyone (subject to little limitation) can become a participant in the validation and consensus process.

[7] Refers to a DLT network in which only the parties that meet certain requirements are entitled to participate to the validation and consensus process.

[8] The EU defines DLT as "a means of saving information through a distributed ledger, i.e., a repeated digital copy of data available at multiple locations. DLT is built upon public-key cryptography, a cryptographic system that uses pairs of keys: public keys, which are publicly known and essential for identification, and private keys, which are kept secret and are used for authentication and encryption."

[9] MiCAR defines a "crypto-asset" as "…a digital representation of a value or a right that is able to be transferred and stored electronically using [DLT] or similar technology."

[10] By 30 December 2024, the European Securities and Markets Authority (**ESMA**) will issue guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments.

The anatomy of MiCAR

Activity around crypto-assets has undisputedly gown significantly over recent years.[11] The risks inherent in crypto-asset activity are, in many respects, not much different from those present in traditional finance save for DLT-specific risks. Regulatory responses to technological innovation are, in principle, a question of time in as much as risks stemming from such ground-breaking activities start to emerge.

Against the backdrop of the "Crypto Winter of 2022/23", marked by high volatility, large-scale downturns, failures of and supervisory investigations directed against both crypto-asset firms as well as crypto-asset friendly traditional financial services firms, the time at which MiCAR is being rolled out could not be more suitable. Slightly over three years following the Commission's initial proposal, MiCAR has been shaped by legislative negotiations, detailed technical input from the European Supervisory Authorities (**ESA**s) - notably the European Securities and Markets Authority (**ESMA**) and the European Banking Authority (**EBA**) - as well as through public "Opinions" issued, inter alia, by the European Central Bank (**ECB**) calling for a number of changes regarding the scope of tokens falling under MiCAR.

Prior to the adoption of MiCAR, applicable law across the EU presented substantial legal uncertainty with regard to the application of existing financial regulation across the EU to crypto activities. Coupled with the, at least from the supervisors' perspective, unusual, often unclear business models in the crypto marketplace, this resulted in fragmentation in the application of existing EU financial regulation among Member States to crypto-assets and DLT more generally. Despite and because of institutional constraints of EU financial regulation, equally harmonised supervisory expectations, consistency as well as certainty as to when enforcement might arise by NCAs became problematic.

As mentioned above and discussed further below, the framework now introduced by MiCAR is very similar to and mimics much of the existing body of EU financial regulation. The approach of MiCAR Title II on offers to the public indeed reflects the same features as introduced under the EU's Prospectus Regulation[12] on simplifying the rules and procedures on publishing a prospectus when offering traditional securities[13] to the public.

Similarly, one can identify parallels to the regulation of investment services under MiFID II/IFR/IFD in the approach that crypto-asset services are regulated under Title V of MiCAR. Moreover, MiCAR includes, inter alia, authorisation requirements, governance and disclosure (ongoing) obligations with common standards for NCAs in conducting licencing, supervision and enforcement tasks as well as a bespoke market abuse regime.

Notwithstanding and given the legal uncertainty resulting from basic terminology around crypto-assets, with MiCAR NCAs should now be better equipped with a comprehensive toolkit to address many of the risks related to crypto-assets, issuers as well as relevant service providers. However, as mentioned in a recent study requested by the EP's committee on economic and monetary affairs (ECON),[14] MiCAR, although a quantum leap in the right direction, is not a one-size-fits-all cure to risks in the crypto industry. To this end, IOSCO in May 2023 published 18 global policy recommendations, addressed to regulators, as a response to widespread concerns in the Crypto and Digital Asset Markets.[15] IOSCO's proposed recommendations and supporting guidance as global standard setter cover a broad range of areas including conflicts of interest, market manipulation, cross-border risks, custody, operational risk and retail distribution, many of which are also addressed under the new MiCAR regime. In what appears to be an alignment in many policy respects, MiCAR and the IOSCO recommendations certainly provide a benchmark for achieving similar investor protection and market integrity standards across the globe similar to those in traditional financial markets.

For the remainder of this Background Briefing, it is advisable, in any case, for crypto-asset market participants to work with professional advisors and legal counsel and reflect on whether their own specific activities and business models are captured by MiCAR or whether they fall into traditional financial services legislation or are, in the alternative not regulated at all. This is a necessary first step to ensuring that adherence to relevant standards of the EU's new rules can be maintained going forward, including with respect to the still, at the time of writing hereof, pending regulatory capital, liquidity and solvency rules that will be introduced in the EU. This sense of urgency has now also been voiced on 12 July 2023 by both ESMA and the EBA, as supplemented by statements form individual NCAs which each have called on market participants to take timely preparatory steps towards the application of MiCAR and those provisions becoming applicable on 30 June 2024.[16]

[11] Current market cap is EUR 1.04 Trillion, while annual expected growth is of 3.79% (CAGR 2023 – 2027). Every 10th household in the EU currently owns crypto-assets and the number of users will be 994.30 Million in 2027.

[12] Regulation (EU) 2017/1129, available here.

[13] Defined as shares bonds and derivatives.

[14] Available here.

[15] Available here.

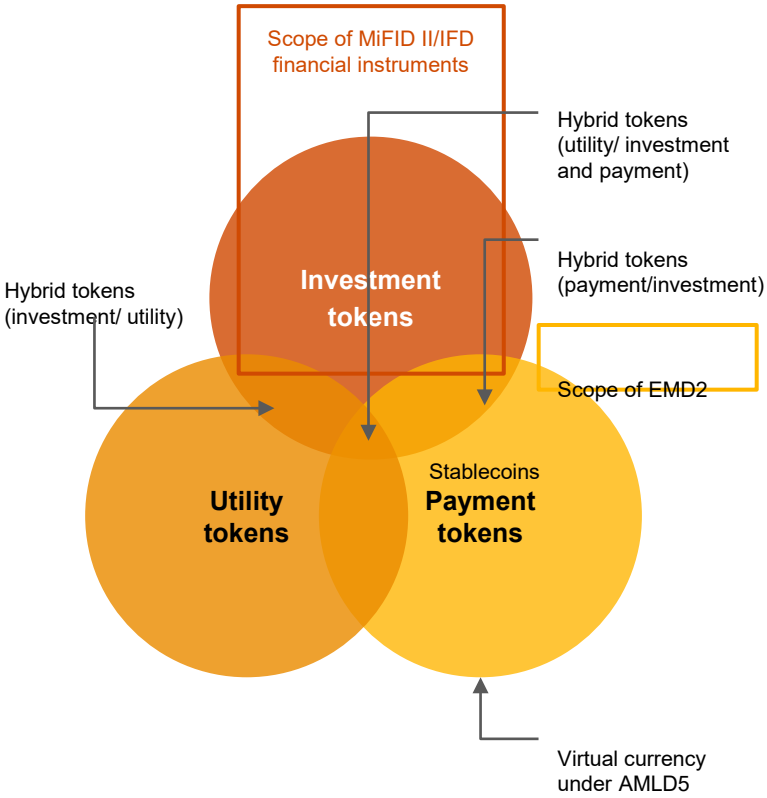
[16] Available here.

A new chapter in the EU's Single Rulebook, expanding the Single Market to crypto-assets

MiCAR provides a harmonised and EU-wide licensing regime plus a single set of conduct of business rules. While some of the Regulation's provisions, notably those on asset-referenced tokens (**ARTs**) and e-money tokens (**EMTs**), will apply from 30 June 2024, other provisions will become applicable from 30 December 2024 i.e., 18 months after MiCAR's entry into force. In anticipation thereof, MiCAR will pursue four general objectives: legal clarity, supporting innovation, consumer and investor protection and ensuring financial stability.[17] Those digital asset native firms as well as traditional financial services firms will want to start preparing now in order to apply and comply with this newest chapter in the Single Rulebook underpinning the Single Market for financial services and now for crypto-assets. As the legislative process continues, EBA has launched on 12 July 2023 consultations on two sets of draft RTS and one set of ITS relating to the authorisation as an issuer of ARTs and the assessment of acquisition of qualifying holdings in issuers of ARTs under MiCAR.[18] Further details on these draft technical standards are set out in further Client Alerts in this series.

Prior to MiCAR, some types of crypto-assets were captured, in part, by existing EU-level financial services regulation (i.e., MiFIR/ MiFID II but also, in limited circumstances, the EU's anti-money laundering rules (**AMLD**s)[19] and/or EU's second E-Money Directive – **EMD2**[20]) as well as national Member States rules (where they existed), which mainly depends on whether the crypto-asset qualifies as 'financial instrument'. Save for the application of some AML rules, the majority of crypto-assets, however, fell outside the scope of currently applicable EU legislation on financial services. While some Member States had consequently introduced specific rules to address risks in the realm of consumer protection and market integrity, MiCAR closes this regulatory void by establishing an overall EU framework.

The EU's new regimes now in place co-exist in parallel and distinguish tokens into two groupings. Currency tokens, utility tokens and stablecoins will fall under the MiCAR regime while security tokens and token-derivatives are captured by the bespoke framework composed of the PDMIR Regime and MiFIR/MiIFD II and thus IFR/IFD. Collectively, this new legislative and regulatory framework aims to promote user confidence in crypto-assets such as to reduce obstacles to the development of a market in said assets, thereby allowing for opportunities in the context of digital innovation, alternative payment instruments as well as new funding sources for EU companies. Regulatory certainty as such is fundamental for the further integration of these markets into the wider economy, as professional investors reduce their scepticism of what was prior to the adoption of MiCAR an unregulated set of activities.



Correspondingly, the majority of crypto-assets which are not already in scope of existing regulation will fall under MiCAR which classifies crypto-assets as follows (see below):

1. asset-referenced tokens (**ART**s);[21]
2. electronic money tokens or e-money tokens (**EMT**s);[22]
3. utility tokens;[23] and
4. other "crypto-assets".

In view of their goal of maintaining a stable value in relation to an underlying reference asset, ARTs and EMTs are also commonly referred to as "**stablecoins**". For the sake of a clear delineation between crypto-assets (governed by MiCAR) on one hand and financial instruments (governed by existing financial services legislation) on the other, the European Securities and Markets Authority (**ESMA**) will issue guidelines on the criteria and conditions on designating digital assets as either in-scope or out of scope of MiCAR by 30 December 2024. Central Bank Digital Currencies (**CBDCs**) issued by the ECB as well as digital assets issued by the European System of Central Banks (**ESCB**) are not subject to MiCAR. CBDC's such as a "digital euro" are subject to a separate EU Regulation – see standalone coverage in this series from our EU RegCORE on that development (here).

[17] see MiCAR, available here.

[18] Available here.

[19] Currently under reform and replacement of various EU Directives with a EU Regulation on anti-money laundering, countering terrorist financing and financial crime prevention (**AMLR**).

[20] Which equally is itself under reform – see EU RegCORE's Client Alert "Introducing the PSD3, PSRs and FIDAR – reshaping the EU's regulatory framework on payment services and e-money" here.

[21] ARTs are defined in MiCAR as "…a type of crypto-asset that is not an electronic money token and that purports to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies." MiCAR defines "official currency" as "an official currency of a country that is issued by a central bank or other monetary authority."

[22] EMTs are defined in MiCAR as "…as a type of crypto-asset that purports to maintain a stable value by referencing the value of one official currency."

[23] Utility tokens are defined in MiCAR as "…a type of crypto-asset that is only intended to provide access to a good or a service supplied by its issuer."

Scope of MiCAR regulated crypto-asset services (1/2)

MiCAR applies to natural and legal persons and "certain other undertakings" (such as decentralised autonomous organisations (**DAOs)** and other decentralised finance (**DeFi**) operators) that are engaged in either (i) the issuance, (ii) offer to the public and admission to trading of crypto-assets and/or that (iii) provide services related to crypto-assets in the EU. This means that MiCAR's application and respective provisions can be distinguished by those persons that are:

A. CAIs – crypto-asset issuers; and
B. CASPs – crypto-asset service providers.

MiCAR's uniform rules on transparency and disclosure requirements for issuance, public offering, and admission to trading as well as a framework on licensing and supervision apply both to CAIs and CASPs.

CAIs, on one hand, will have to meet a number of obligations prior to beginning with offerings of crypto-assets (other than ARTs or EMTs) to the general public in the EU or in order to request admission of such crypto-assets for trade on a trading platform. These include the obligation to publish a so-called 'whitepaper' which describes the technical information of the crypto-asset.

Notably, this obligation does not apply where an offering is made to fewer than 150 natural or legal persons per Member State, the total consideration of which does not exceed EUR 1 million or if the offering is addressed exclusively to qualified investors. Third country issuers must, in general, be established in the EU as MiCAR does not provide for a separate third country regime.

CASPs, on the other, are subject to generally applicable requirements as well as service-specific tailored requirements. The general requirements cover authorisation and supervision as well as prudential and governance requirements. Anyone wishing to apply to become a CASP, for instance, must have a registered office in an EU Member State and have obtained an authorisation to provide one or more regulated crypto-asset services from an NCA.

Any person that wishes to undertake MiCAR regulated crypto-asset services as a CASP requires an authorisation to do so. The regulated crypto-asset services include any of the following services and activities relating to any crypto-asset:

MiCAR regulated crypto-asset service or activity		Relevant definition in MiCAR
A	providing custody and administration of crypto-assets on behalf of clients	'providing custody and administration of crypto-assets on behalf of clients' means the safekeeping or controlling, on behalf of clients, of crypto-assets or of the means of access to such crypto-assets, where applicable in the form of private cryptographic keys
B	operation of a trading platform for crypto-assets	'operation of a trading platform for crypto-assets' means the management of one or more multilateral systems, which bring together or facilitate the bringing together of multiple third-party purchasing and selling interests in crypto-assets, in the system and in accordance with its rules, in a way that results in a contract, either by exchanging crypto-assets for funds or by the exchange of crypto-assets for other crypto-assets
C	exchange of crypto-assets for funds	'exchange of crypto-assets for funds' means the conclusion of purchase or sale contracts concerning crypto-assets with clients for funds by using proprietary capital. Funds refers to banknotes and coins, scriptural money or e-money as such definition is used in the EU's second Payment Services Directive (PSD2)[24]
D	exchange of crypto-assets for other crypto-assets	'exchange of crypto-assets for other crypto-assets' means the conclusion of purchase or sale contracts concerning crypto-assets with clients for other crypto-assets by using proprietary capital
E	execution of orders for crypto-assets on behalf of clients	'execution of orders for crypto-assets on behalf of clients' means the conclusion of agreements, on behalf of clients, to purchase or sell one or more crypto-assets or the subscription on behalf of clients for one or more crypto-assets, and includes the conclusion of contracts to sell crypto-assets at the moment of their offer to the public or admission to trading
F	placing of crypto-assets	'placing of crypto-assets' means the marketing, on behalf of or for the account of the offeror or a party related to the offeror, of crypto-assets to purchasers
G	reception and transmission of orders for crypto-assets on behalf of clients	'reception and transmission of orders for crypto-assets on behalf of clients' means the reception from a person of an order to purchase or sell one or more crypto-assets or to subscribe for one or more crypto-assets and the transmission of that order to a third party for execution
H	providing advice on crypto-assets	'providing advice on crypto-assets' means offering, giving or agreeing to give personalised recommendations to a client, either at the client's request or on the initiative of the crypto-asset service provider providing the advice, in respect of one or more transactions relating to crypto-assets, or the use of crypto-asset services
I	providing portfolio management of crypto-assets	'providing portfolio management of crypto-assets' means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more crypto-assets
J	providing transfer services for crypto-assets on behalf of clients	'providing transfer services for crypto-assets on behalf of clients' means providing services of transfer, on behalf of a natural or legal person, of crypto-assets from one distributed ledger address or account to another

[24] Which as with EMD2 is under review – see standalone coverage from our EU RegCORE "Introducing the PSD3, PSRs and FIDAR -reshaping the EU's regulatory framework on payment services and e-money", here.

Scope of MiCAR regulated crypto-asset services (2/2)

Once a MiCAR authorisation is obtained in one Member State, the CASP can passport its regulated activities across the EU. Service-specific requirements, instead, address the type of regulated service a CASP may wish to provide (e.g., custody and administration or a trading platform) and include, for example, a prohibition for trading platforms to deal on own account. Similar to CAIs, with the exception of reverse solicitation, MiCAR requires that CASPs must be a legal person or undertaking with registered office, effective management and a director in the EU.

Notably, MiCAR exempts CRR[25] credit institutions from authorisation where they wish to offer or seek admission to trading of ARTs. They are instead required to notify the relevant NCA such that these can verify the issuer's ability to perform those services.

In the context of supervising CASPs and CAIs, NCAs will act as the font-line supervisors and enforcement agents of both CASPs and CAIs with the goal of ensuring compliance, the promotion of market integrity as well as consumer protection. Accordingly, NCAs will apply a modified supervisory toolbox including using on-site and off-site inspections, thematic reviews, and regular supervisory dialogue to identify, monitor and request remedies to compliance shortcomings of CASPs and/ or CAIs. Supervisory responsibility of issuers of significant ARTs will fall to the EBA while for issuers of significant EMTs the supervisory responsibility will be shared by EBA and the NCAs. Where CASPs have more than 15 million active users in the EU on average over a time period of 12 months they will be classified as significant and ESMA must be kept informed by the relevant NCA – which continues to hold supervisory responsibility – on an ongoing basis about key supervisory developments.

MiCAR is clear in Article 2(2) that MiCAR **does not apply** to:

Excluded persons	PwC Legal's comments
Persons who provide crypto-asset services exclusively for their parent companies, for their own subsidiaries or for other subsidiaries of their parent companies	Such intragroup exemption is similar to traditional financial services legislation and may provide a number of reliefs for intragroup utility and/or settlement tokenomics
A liquidator or an administrator acting in the course of an insolvency procedure, except for the purposes of Article 47 (MiCAR) (*Redemption Plan*) applicable to ART CAIs	It is expected that further guidance may be warranted here to explain whether this is applicable also to other proceedings of analogous effect to that of an insolvency
the ECB, central banks of the Member States when acting in their capacity as monetary authorities, or other public authorities of the Member States	CBDCs issued by the ECB and ESCB are excluded
the European Investment Bank (**EIB**) and its subsidiaries	EIB tokenised instruments, such as the digital bond issued January 2023 would be excluded from MiCAR's application to the EIB
the European Financial Stability Facility (**EFSF**) and the European Stability Mechanism (**ESM**)	Respective tokens would be excluded from MiCAR's application to the EFSF and ESM
public international organisations	Same as above, although it is not fully clear what is included or excluded in this term
crypto-assets that are unique and not fungible with other crypto-assets	• As a result, so-called non-fungible tokens (**NFT**s) and NFT platforms are excluded if they meet certain exclusion criteria [28], although may be subject to additional regulatory scrutiny elsewhere, notably on financial crime legislation and further MiCAR relevant ITS and RTS • In some Member States that had their own national frameworks and where (sufficient) clarity was provided that NFTs would be regulated under that regime, MiCAR means those Member States have to remove the regulation and supervision of NFTs
Crypto-assets that qualify as one or more of the following: • financial instruments • deposits, structured deposits • funds, except if they qualify as EMTs[27] • securitisation positions in the sense of the Securitisation Regulation • non-life or life insurance products as listed in the EU's Solvency II Directive • pension products, that under national law are recognised as having the primary purpose of providing the investor with an income in retirement and that entitle the investor to certain benefits • officially recognised occupational pension schemes within the scope of EU's IORPS II Directive or Solvency II Directive • individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider • pan-European personal pension products pursuant to the EU's PEPP Regulation • social security schemes covered by EU Regulations on the coordination of social security systems	• This "exclusion" from MiCAR means an "inclusion" in respective traditional financial services legislation • ESMA is required, by 30 December 2024 to publish guidelines on the scope of criteria to determine inclusion as a financial instrument. It is conceivable that ESMA, the EBA and EIOPA may have to do the same for the other aspects if there is confusion

[25] See Regulation (EU) No 575/2013

[26] The Commission is tasked to prepare a comprehensive assessment within 18 months and (if necessary) bring forward a legislative proposal to create a legislative and regulatory regime for NFTs.

[27] It should be noted that MiCAR defines "funds" by cross reference to the definition in PSD II, which states: 'funds' means banknotes and coins, scriptural money or electronic money… [issued under the E-Money Directive – EMD II]."

[28] See ESRB Task Force on Crypto-Assets and Decentralised Finance Report, , available here

Further clarity on taxonomy and scope (1/2)

Having been introduced with the underlying rationale of covering a regulatory gap, MiCAR walks a thin line between filling this void and avoiding overlaps with definitions already captured by existing EU financial regulation. This clear-cut approach to regulating financial services in a yet evolving market will indeed provide certainty albeit only temporarily while the number of tools MiCAR has equipped itself with on how to address this tension in delineation, described below, will set the trajectory depending on developments around the crypto-asset marketplace.

Throughout the legislative process the ECB, in its Opinion, called for a clearer definition of what constitutes a crypto-asset and would thus fall under MiCAR. The ECB urged such changes in order to "avoid diverging interpretations at national level on what may or may not constitute a crypto-asset (…) to help support the provision of crypto-asset services on a cross-border basis and to establish a truly harmonised set for crypto-assets". Accordingly, MiCAR applies a harmonised set of rules across Member States by introducing a consistent set of terms that foster regulatory certainty. Market participants will want to assess whether they are subject to this categorisation and hence, whether they fall under MiCAR.

Assets in scope of MiCAR and token classifications

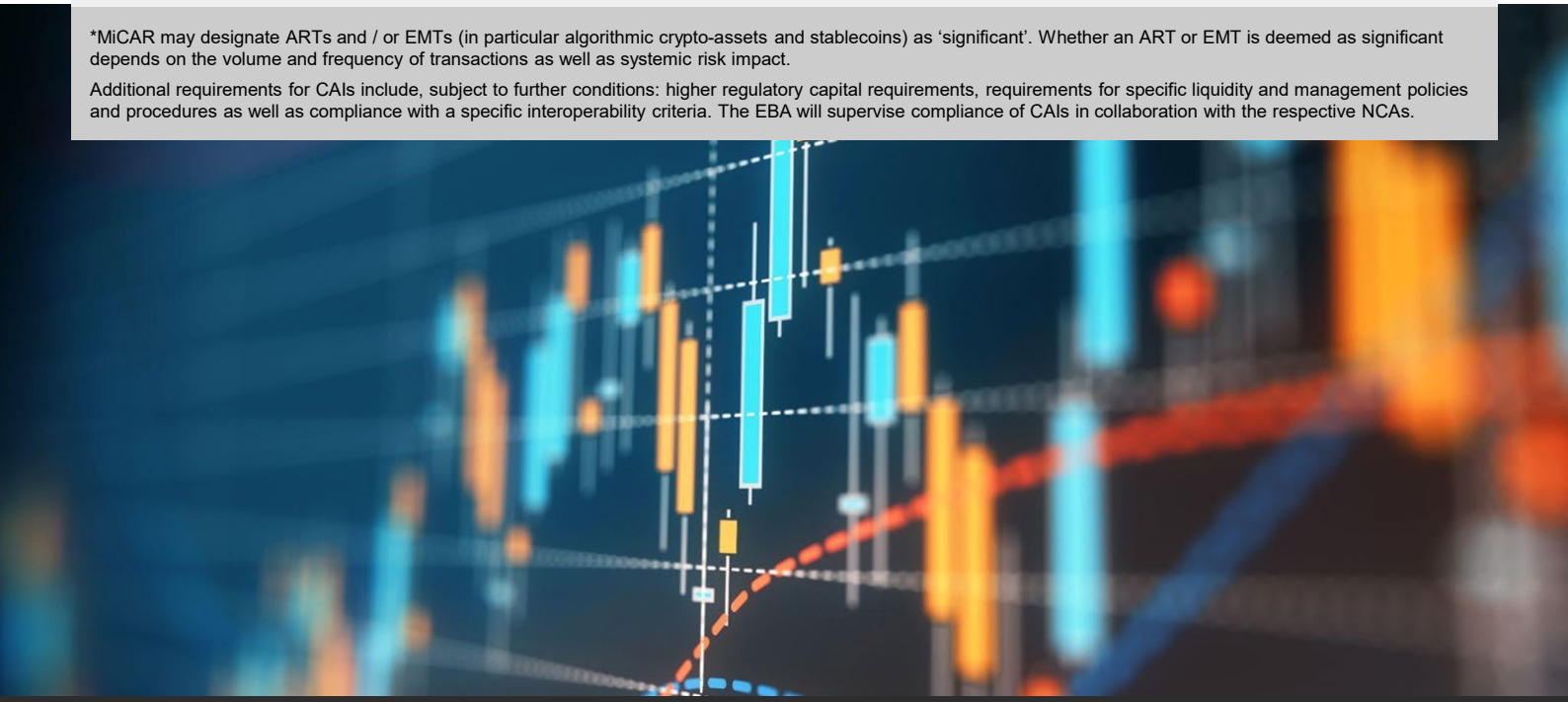
Asset-referenced tokens (ART)	Electronic money tokens (EMT)	Other crypto-assets
Tokens aiming to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies,	DLT equivalents for coins and banknotes and used as payment tokens. EMTs must be backed by one fiat currency which is a legal tender.	Tokens with a digital representation of value or rights which may be transferred and stored electronically. Utility tokens which provide access to a good or service and only accepted by the issuer of that token. Payment tokens which are not EMTs or security tokens.
Significant tokens* and stablecoins		
Algorithmic crypto-assets and algorithmic stablecoins		

Assets in scope of MiCAR

EU Financial Instruments (regulated elsewhere)	Other Digital Assets (including)
Digital assets governed by the existing financial services rules, as amended, including security tokens and derivatives on crypto-assets.	• Digital assets which cannot be transferred, are offered for free or are automatically created • Central bank digital currencies (CBDCs) • Non-fungible tokens (NFTs) • Decentralised finance (DeFi) protocols

*MiCAR may designate ARTs and / or EMTs (in particular algorithmic crypto-assets and stablecoins) as 'significant'. Whether an ART or EMT is deemed as significant depends on the volume and frequency of transactions as well as systemic risk impact.

Additional requirements for CAIs include, subject to further conditions: higher regulatory capital requirements, requirements for specific liquidity and management policies and procedures as well as compliance with a specific interoperability criteria. The EBA will supervise compliance of CAIs in collaboration with the respective NCAs.



Further clarity on taxonomy and scope (2/2)

A range of crypto-assets will fall under the scope of MiCAR. As mentioned above, these are grouped into three categories, namely: E-money tokens (**EMT**s), Asset-referenced tokens (**ART**s) and utility tokens.

EMTs are primarily used as a medium of exchange that purports to maintain a stable value by referencing to the value of one official currency while not being issued or guaranteed by a central bank. As such, these include, e.g., bitcoin, ether or Dogecoin.

ARTs are distinct in that they purport to maintain a stable value by referencing to another value or right or a combination thereof, including one or more official currencies. Correspondingly, the underlying reference may include real estate, commodities, or other financial instruments. ARTs may be used for investment purposes although issuers thereof will be obliged to safeguard and maintain the reserve assets that stabilise the value of the tokens. USD Coin (USDC) is one such example.

Utility tokens, however, do not fulfil the functions of means of payment and/or store of value but are a type of crypto-asset which is only intended to provide access to a good or a service supplied by its issuer, such as a digital service or application within a blockchain-based network.

The importance of a consistent and clearly defined terminology is reflected both by the ECB and the ESRB. The ESRB stresses this in its report with regards to regulating the crypto-asset ecosystem, in light of the tendency to rely on well-established language from the traditional financial system. The ESRB calls for caution, especially in the context of marketing materials, with regards to the interpretation of language used in this context. Terms such as “currency” or “(crypto) asset” should, accordingly, be clearly distinguished. Money is described as being underpinned by a legal system and as fulfilling three functions: means of exchange, unit of account and a store of value. All these properties of money, the report underlines, are not fulfilled by unbacked tokens nor by reserve-backed stable coins.

On this note, however, and in view of the payment function of ARTs, the ECB, in its Opinion, called for powers so that where the latter are “tantamount to a payment system or scheme, the assessment of the potential threat to the conduct of monetary policy, and to the smooth operation of payment systems, should fall within the exclusive competence of the ECB”.

To the same extent, the ECB had stressed the need for further consideration by the co-legislators concerning the interplay between MiCAR and PSD II in the context of consumer protection and security. Under PSD II, certain asset services may fall within the definition of payment services. Consequently, upon legislative negotiations, the ECB plus national central banks have been given powers to veto an authorisation where there are concerns related to the smooth operation of payment systems, monetary policy, or monetary sovereignty.

The ESRB underlines that the term crypto-asset should be treated with caution in light of the term “asset” denoting that something is valuable, although crypto-assets cannot commonly be defined as something with a clear intrinsic value. Whereas the value of reserve-backed tokens can be traced back to traditional financial assets, unbacked tokens, by contrast, may carry some of the properties of traditional financial assets, even though lacking intrinsic value, such as the identification of claims as well as economic benefits which can be derived from conversion into fiat currency.[28]

In light of these uncertainties, it does not come as a surprise that IOSCO Recommendation no. 13 urges regulators to require CASPs to hold client assets separate from their proprietary assets and place client assets in a segregated bankruptcy remote account (or provide equivalent protection through the available means in the relevant jurisdictions as such). IOSCO goes further in that it calls on CASPs to specify how client’s assets are protected against loss or misuse and how such assets ultimately do not become subject to claims of the CASP’s creditors. MiCAR embraces this recommendation considerably in respect of its own safekeeping rules. Specifically, where business models lead to the holding of client funds, MiCAR sets out rules to protect client funds and which prevent the use for own account as well as requiring CASPs to place client funds with a central bank or a CRR institution. Regardless of the specific crypto-asset provided, however, market participants will have to revisit the requirements they will become subject to, in respect of the services they offer, under MiCAR.

[28] See ESRB Task Force on Crypto-Assets and Decentralised Finance Report, , available here

Key considerations for crypto-asset issuers (CAI) (1/3)

CAIs are any legal person who offer to the public any type of crypto-assets or seek admission of such crypto-assets to trading platforms for crypto-assets. Whereas the applicable framework will depend on the type of crypto-asset being offered – ordinary crypto-assets or ARTs/EMTs - MiCAR introduces new requirements for these issuers. Notably, MiCAR sets out that no issuer of crypto-assets (other than ART or EMT, or those that are exempt) shall offer such crypto-assets to the public or seek admission to trading of such crypto-assets in the EU, unless that issuer has satisfied certain requirements.

Generally, the framework introduced by MiCAR requires that a CAI, before making an offer of crypto-assets (other than ARTs or EMTs) to the general public or in order to request admission of such crypto-assets to trade on a trading platform, will have to:

I. be incorporated as a legal entity in the EU (cannot be a natural person acting in own name);

II. publish (online) a crypto-asset whitepaper describing the technical information of the crypto-asset (see *Compliance-Box (1)* below);

III. offer those consumers purchasing crypto-asset issuances (other than for ARTs and EMTs) a 14-calendar day right of withdrawal without requiring reasons and a corresponding reimbursement (without undue delay) of all payments received from a consumer;

IV. comply with the requirements that generally apply to all crypto-assets (other than ARTs and EMTs), namely to:

   A. act honestly, fairly and professionally,

   B. communicate with crypto-asset holders in a fair, clear and not misleading manner

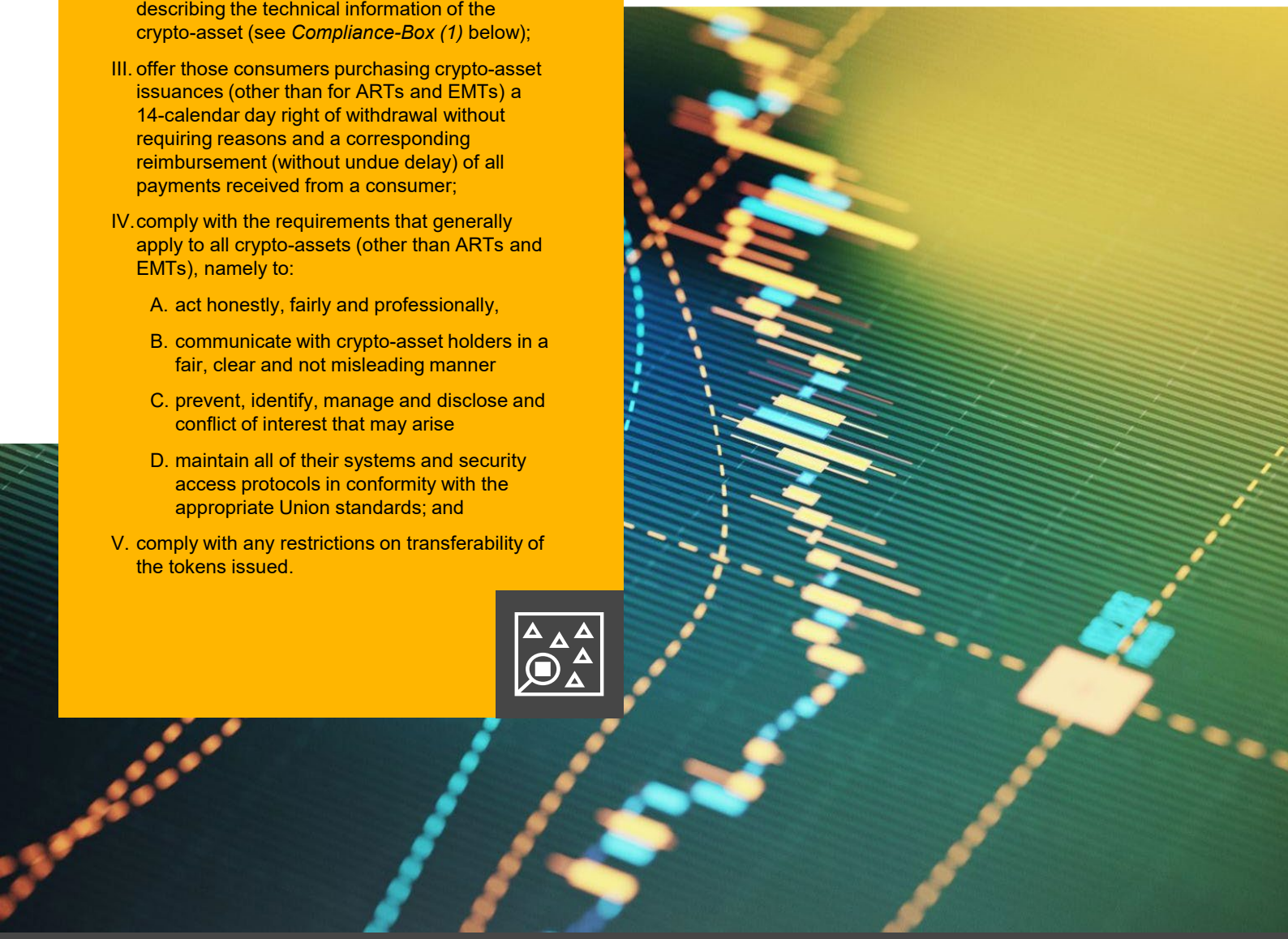
   C. prevent, identify, manage and disclose and conflict of interest that may arise

   D. maintain all of their systems and security access protocols in conformity with the appropriate Union standards; and

V. comply with any restrictions on transferability of the tokens issued.

MiCAR introduces a so-called whitepaper framework for minimum disclosure requirements containing the technical description, including the risk factors of the crypto-asset in question. As is reflected in other elements of MiCAR, the disclosure requirements mirror the concepts and requirements already existing under EU financial law, that is the EU's Prospectus Regulation framework. The whitepaper disclosure requirements also incorporate a range of principles established in respective national crypto-asset regimes, for example that disclosures must be fair, clear and not misleading. Whitepapers should entail a summary setting out briefly and in non-technical language the key information regarding the offer made to the public.

Whitepapers must be notified to the applicable NCA. CAIs are also obliged, upon request, to notify the applicable NCA of their marketing communications. The legislative negotiations have resulted in abolishing any requirement by the NCAs for CAIs to have their crypto-asset whitepapers or marketing communications approved prior to respective publication.



Key considerations for crypto-asset issuers (CAI) (2/3)

Compliance-Box (1): whitepaper requirements
Under MiCAR, each whitepaper:

Must be notified to the NCA of the home Member State of offerors, persons seeking admission to trading or operators of trading platforms for crypto-assets other than ARTs or EMTs.

Must be accompanied by an explanation of why the crypto-asset described should not be considered to be:

1. A crypto-asset excluded from the scope of this Regulation pursuant to Article 2(4);
2. An EMT; or
3. An ART.

Will need to be notified to the NCA of the home Member State at least 20 days prior its date of publication;

Must be notified to the NCA of the home Member State by offerors and persons seeking admission to trading of crypto-assets other than ARTs and EMTs which must provide such NCA with a list of the host Member States - if any - where they intend to offer thor crypto-assets to the public or intend to seek admission to trading. They shall also inform the competent authority of their home Member State of the starting date of the intended offer to the public or intended admission to trading and of any change to that date.

Shall contain all of the following information:

1. Information about the offeror or the person seeking admission to trading;
2. Information about the issuer, if different from the offeror or person seeking admission to trading;
3. Information about the operator of the trading platform in cases where it draws up the white paper;
4. Information about the crypto-asset project;
5. Information about the offer to the public, of the crypto-asset or its admission to trading;
6. Information about the crypto-asset;
7. Information on the rights an obligations attached to the crypto-asset;
8. Information on the underlying technology;
9. Information on the risks; and
10. Information on the principal adverse impacts on the climate and other environment-related adverse impacts of the consensus mechanism used to issue the crypto-asset.[29]

All the information provided on the whitepaper shall be fair, clear and not misleading. The whitepaper shall also not contain material omissions and shall be presented in a concise and comprehensible form.

The whitepaper shall contain the following clear and prominent statement on the first page:

'This crypto-asset white paper has not been approved by any competent authority in any Member State of the European Union. The offeror of the crypto-asset white is solely responsible for the content of this crypto-asset white paper'

Where the whitepaper is drawn up by the person seeking admission to trading or by an operator of a trading platform, then, instead of 'offeror', a reference to 'person seeking admission to trading' or 'operator of the trading platform' shall be included in the statement referred to in the first subparagraph.

The whitepaper shall not contain any assertions as regards the future value of the crypto-asset, other than the following, clear and unambiguous, statement:

1. The crypto-asset may lose its value in part or in full;
2. The crypto-asset may not always be transferable;
3. The crypto-asset may not be liquid;
4. Where the offer to the public concerns a utility token, that utility token may not be exchangeable against the good or service promised in the crypto-asset white paper, especially in the case of a failure or discontinuation of the crypto-asset project;
5. The crypto-asset is not covered by the investor compensation schemes under Directive 97/9/EC of the European Parliament and of the Council; and
6. The crypto-asset is not covered by the deposit guarantee schemes under Directive 2014/49/EU.

The whitepaper shall contain a statement from the management body of the offeror, the person seeking admission to trading or the operator of the trading platform. Such statement shall confirm that the crypto-asset whitepaper complies with the requirements and that, to the best of the knowledge of the management body, the information presented in the crypto-asset whitepaper is fair, clear and not misleading and the whitepaper makes no omission likely to affect its import.

A summary shall be inserted after this statement, in brief and non-technical language about the offer to the public or the intended admission to trading. The summary shall be easily understandable and presented and laid out in a clear and comprehensive format, using characters of readable size. It shall also contain appropriate information about the characteristics of the crypto-asset concerned to allow the prospective holders to make an informed decision.

This summary shall contain a warning that:

1. It should be read as an introduction to the whitepaper;
2. The prospective holder should base any decision to purchase the crypto-asset on the content of the whitepaper as a whole and not on the summary alone;
3. The offer to the public of the crypto-asset does not constitute an offer or solicitation to purchase financial instruments and that any such offer or solicitation can be made only by means of a prospectus (or other documents pursuant to applicable national law); and
4. The whitepaper does not constitute a prospectus as referred to in Regulation (EU) 2017/1129 of the European Parliament and of the Council or any other offer documented pursuant to Union legislation or national law.

Other requirements include:

- The whitepaper shall contain the date of its notification and a table of contents;
- The whitepaper shall be drawn up in an official language of the home Member State, or in a language customary in the sphere of international finance (where it is offered in Member States other than the home Member State, the whitepaper shall also be drawn up in an official language of the host Member State or in a language customary in the sphere of international finance); and
- The whitepaper shall be made available in a machine-readable format.

[29] ESMA, in cooperation with EBA will develop draft regulatory technical standards on the content, methodologies and presentation of the information to this end, in respect of sustainability indicators in relation to adverse impacts on the climate and other environment-related adverse impacts

Key considerations for crypto-asset issuers (CAI) (3/3)

MiCAR also clarifies that there are exemptions to the requirement of drafting, notifying and publishing a whitepaper. Correspondingly, CAIs are exempt from the whitepaper requirement for such tokens which are:

- offered either for free; automatically (i.e., created through mining as a reward for DLT maintenance or the validation of transactions);
- to fewer than 150 natural or legal persons per EU Member State where such persons are acting on their own account;
- offered over a 12-month period with a total consideration of the public offer not exceeding EUR 1 million;
- solely addressed to qualified investors and the crypto-assets can only be held by such qualified investor; and
- not fungible with other crypto-assets;

In addition to these generally applicable requirements for CAIs, those seeking to issue ARTs or EMTs are subject to additional requirements. Said issuers require prior authorisation from the relevant NCA and must be established in the EU. The additional requirements apply both to the authorisation and ongoing compliance, especially when these are labelled as significant. An exemption from the authorisation requirements applies where the issuer is a credit institution or where an entity, over a 12-month period, issues an average outstanding amount of ARTs/EMTs, as calculated at the end of each calendar day, not exceeding EUR 5 million and the offer is addressed solely to qualified investors and can only be held as such issuers of EMTs are required to comply with all the requirements applicable to an E-money institution within the meaning of EMD2. EMT issuers will therefore either have to qualify as a CRR authorised institution or an EMD2 e-money institution which is authorised in the EU. Respectively, their offerings are subject to additional requirements including public disclosure of various policies and procedures as well as further disclosures of safeguards of reserve funds and internal control systems.

ART issuers will need to ensure that they observe the own funds requirements, whichever higher, of either EUR 350,000 or 2% of the average amount of the reserve assets referred to in Article 36 MiCAR or a quarter of the fixed overheads of the preceding year. Both ART and EMT issuers will have to implement and maintain robust governance arrangements including a remuneration policy that promotes sound and effective risk management of such issuers and that does not create incentives to relax risk standards. They will also have to have embedded conflicts of interest policies and procedures as well as operate a detailed complaints-handling and qualifying holding procedures. In what is probably applauded by IOSCO, EMT and ART issuers will have to ensure safe custody and segregation of the funds received in exchange for tokens with credit institutions or CASPs. For EMTs, at least 30% of the fund received must always be deposited in separate accounts in credit institutions. MiCAR also introduces a requirement for EMT issuers that remaining funds (given 30% of which deposited with credit institutions) are invested in secure, low risk assets qualifying as highly liquid financial instruments within minimal market risk, credit risk and concentration risk and denominated in the same currency as the one referenced in the EMT. MiCAR provides NCAs the option to also set up additional requirements.

In its recommendations, IOSCO has issued three principles as applicable to issuers of crypto-assets. Correspondingly, issuers should always fully and accurately disclose financial results in a timely manner as well as the risks and other information which is material to investors' decisions. Second, holders of securities in a company should be treated in a fair and equitable manner. Thirdly, accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable standard.

Key considerations for crypto-asset Service Providers (CASPs) (1/7)

CASPs are defined as legal person or undertaking whose occupation or business is the provision of one or more crypto-asset services to clients on a professional basis. They are subject to a material requirement under MiCAR in that the place of their actual management must be within the EU and they must employ at least one managing director resident in the EU and have acquired authorisation by the relevant NCA. In similar fashion to CAIs, where an entity is already licensed respectively under CRR/CRD, MiFIR/MiFID II, IFR/IFD – i.e., central securities depositories and investment firms – and such entity seeks to become authorised as a CASP, MiCAR allows for an accelerated procedure (prior notification to relevant NCA) to "top up" permissions for MiCAR activities. As the legislative process continues on RTS/ITS, on 12 July 2023, ESMA published a first consultation paper on technical standards specifying certain requirements for CASPs under MiCAR. In particular the consultation paper relates to the content, forms and templates for the application for authorisation of CASPs, the complaints-handling procedure, the identification, prevention, management and disclosure of conflicts of interest by CASPs and the assessment of intended acquisition of qualifying holdings requirements. Further details on these draft technical standards are set out in further Client Alerts in this series.

After submitting the authorisation application, the relevant NCA will assess, within 25 business days, whether the application is complete or, in the alternative, issue a deadline for the submission of further information. Where an application remains incomplete even after the deadline has lapsed, the NCA may refuse to proceed with the application. Where an application is complete, however, the NCA has 40 business days to assess the application and reach a conclusion. The applicant must be informed without delay about the completeness of the application, although the NCA remains entitled to 20 additional business days to request additional information. In such a scenario the assessment period is suspended by a maximum of 20 business days, during which the applicant must submit the requested information. The authorisation procedure may either lead to an approval or rejection which must be communicated to the applicant. Ultimately, successfully licensed CASPs are listed on a register provided by ESMA.

Once authorised, CASPs are subject to both generally applicable - disclosure, supervision and prudential – requirements which all crypto-asset service providers must observe, as well as service-specific requirements which extend to prudential requirements, governance and organisation, operational risk and money laundering prevention measures.

MiCAR also extends existing market integrity provisions addressing market abuse including insider information, insider dealing as well as market manipulation. These market abuse requirements under MiCAR were significantly expanded throughout the legislative negotiations although leading academics have criticised that, when compared to the legislative framework developed under the MAR, the rules on market abuse in MiCAR are still quite short.[30]

Besides the set of applicable general requirements, CASPs must observe prudential requirements, governance and organisation, operational risk and money laundering rules. Notably, MiCAR also introduces a change in control regime covering acquisitions and/or disposition of CASPs. The virtual similarity of MiCAR to existing EU financial law can also be identified in this regime in that it mimics existing EU rules and principles on change in control, with the exception of prolonged administrative time limits granted in the context of processing and review.

Many of these requirements above are echoed in IOSCO's policy recommendations in view of recent turmoil in the market, related to an increased perception of fundamental issues concerning governance, conduct and market abuse. IOSCO Recommendation 8 on fraud and market abuse, for instance, stresses the importance of regulating crypto-asset markets in a manner which prevents the same types of fraudulent and manipulative practices (e.g., unlawful disclosure, insider dealing and market manipulation) present in traditional financial markets. IOSCO is therefore calling on regulators to review their offence provisions and apply them in a manner that any potential gaps and new market developments are sealed. On a similar note, the ESRB underlines that while many policy discussions have focused, and progressed, on consumer and investor protection, the broader financial stability implications of recently surfaced shortcoming remain unclear.[31]

With respect to prudential requirements, general conduct of business rules must be abided by. CASPs must act fairly and in the interest of clients. They must be able to absorb losses as well as being wound down in an orderly manner for which they must respect minimum capital requirements, depending on the type of crypto-asset service provided. With regards to provision of crypto-asset services across the EU, amid the passporting regime, MiCAR introduces a minimum capital requirements framework for CASPs. CASPs will have to abide by the following, whichever higher, prudential capital requirements

1. minimum capital requirements (**MCR**s), which are dependent on the nature of the crypto-asset service provided. The MCRs are categorised therefore on the basis of the classes set out below;[32] and
2. One quarter of the fixed overheads requirement (**FOR**) [33] of the preceding year, as reviewed annually.

[30] Zetzsche/Buckley/Arner/van Ek, Remaining regulatory challenges in digital finance and crypto-assets after MiCAR, publication for the Committee on Economic and Monetary Affairs (ECON), Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg

[31] See ESRB Task Force on Crypto-Assets and Decentralised Finance Report, , available here

[32] This approach has been recently adopted by the European Commission across a range of other areas to delineate systemic importance. Notably, this order has been inversed in respect to the class treatment under IFR, IFD which categorises Class 1 firms as riskier and Class 3 firms as less risky. Compare also with non-EU domiciled central counterparties under regulatory reforms

[33] Calculated using figures resulting from the applicable accounting framework, by subtracting the following items from the total expenses after distribution of profits to shareholders in their most recently audited annual financial statements or, where audited statements are not available, in annual financial statements validated by national supervisors:

- staff bonuses and other remuneration, to the extent that those bonuses and that remuneration depend on a net profit of the CASP in the relevant year;
- employees', directors' and partners' shares in profits;
- other appropriations of profits and other variable remuneration, to the extent that they are fully discretionary; and
- non-recurring expenses from non-ordinary activities

Key considerations for crypto-asset Service Providers (CASPs) (2/7)

CASP type category	Type of services provided	MCR level in EU
Class 1	**CASPs authorised for the following crypto-asset services:** • reception and transmission of orders on behalf of third parties and/or providing advice on crypto-assets; and/ or • execution of orders on behalf of third parties; and/or • placing of crypto-assets	**EUR 50,000**
Class 2	**CASPs authorised for any crypto-asset services activity under Class 1, and;** • custody and administration of crypto-assets on behalf of third parties	**EUR 125,000**
Class 3	**CASPs authorised for any crypto-asset services activity under Class 2 and;** • exchange of crypto-assets for fiat currency that is legal tender; • exchange of crypto-assets for other crypto-assets; and/or • operation of trading platform for crypto-assets	**EUR 150,000**

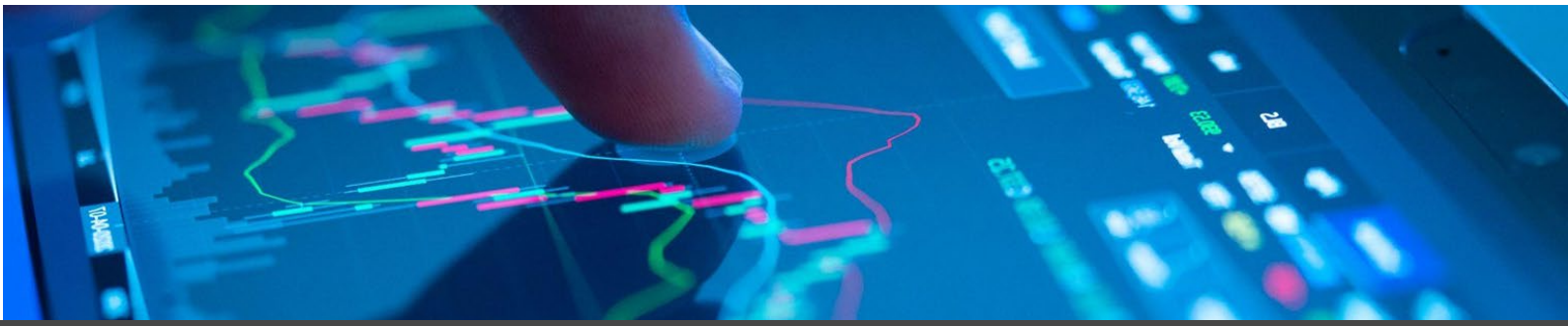
It should be noted that, perhaps somewhat confusingly, the IFR/IFD regime and its own "classes" are reverse in order, so that a Class 3 IFR/IFD firm is the least risky type of firm with the simplest type of activities.

In January 2023, the European Parliament proposed that a maximum possible risk weight (i.e., 1,250) should be applied to unbacked crypto-assets. In essence, this would imply that for each euro of crypto-assets issued lenders would have to hold a euro of capital. This proposal has been met with positive response from Member States governments. Whether a considerably prudent approach as such would be met, on the flip side, with eased risk weights, for stablecoins, for instance, remains to be seen. Please see our standalone coverage on this series on the EU prudential capital framework's treatment of crypto-asset exposures for financial services firms.

CASPs must also implement prompt and equitable complaints-handling procedures. To this end, MiCAR introduces a set of definite rules for the relationship between CAIs and the ultimate token holder. Notably, in an environment of increasing cyber risks, CASPs must be able to protect against hacks and bugs in the blockchain as to which MiCAR has introduces rules on adequate IT security procedures and systems in place which can guard against such risks and IT failures. The latter rules must be adhered to in view of CASPs falling under the scope of the Digital Operational Resilience Act (**DORA**). Furthermore, CASPs are included in the list of "obliged entities" under the AML framework, subjecting them to the AML/CFT rules in the context of the Financial Action Task Force.

Depending on the services a CASP may wish to provide, MiCAR contains a list of specific requirements tailored to the applicable and regulated crypto-asset service. These cover, for example, the custody or safekeeping of crypto-assets which would require the establishing of a custody policy with segregated holdings, daily reporting of holding and have a liability for loss of client's crypto-assets in the event of malfunctions of cyber-attacks. In what is certainly welcomed by IOSCO, for CASPs seeking to hold client's crypto-assets, for example, MiCAR introduces a client segregation requirement (omnibus accounts being allowed). At the same time, subject to prior client consent, rehypothecation and/or rights of use are permitted. On the flip side, as the 'stick', however, MiCAR requires client funds to be held in a client fund account with a CRR credit institution or a central bank.

CASPs seeking to offer administration and custody services on behalf of third parties will also be subject to certain conduct of business and disclosure obligations. MiCAR requires the separation of customer assets from their own assets as well as the separation – operationally and legally – from the custodian's assets. Under MiCAR, CASPs moreover become liable for assets given in custody. To this end, as mentioned above, in light of IOSCO Recommendation no. 13, MiCAR is certainly on the right path with respect to asset and monies segregation requirements.

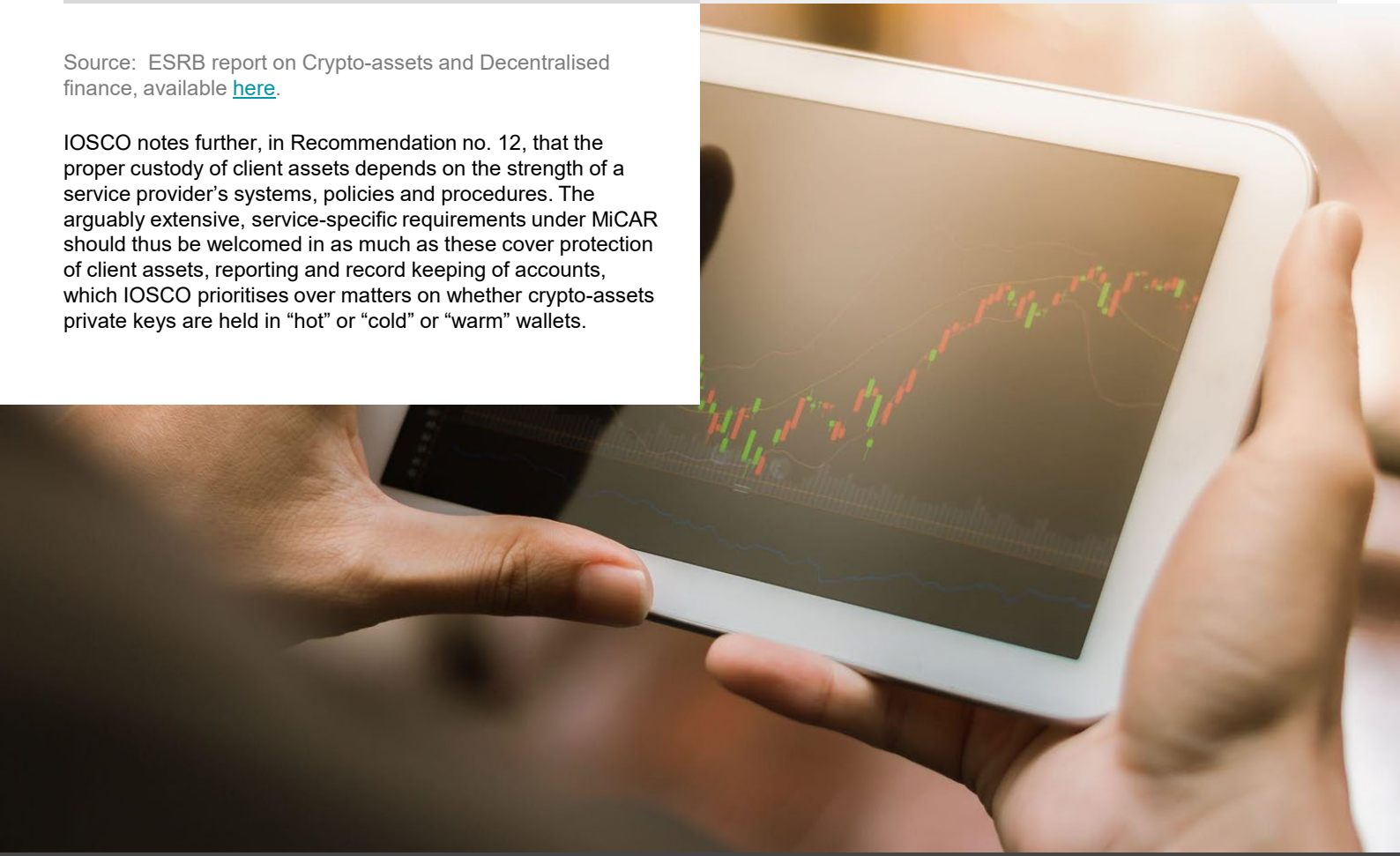


Key considerations for crypto-asset Service Providers (CASPs) (3/7)

Crypto-asset service	Requirements
Custodians	Contractual arrangements with clients, register of positions of clients, asset segregation, liability.
Trading platforms	Operating rules, prohibition of dealing on own account for the CASP, resilience of trading systems, pre-and post-trade transparency, obligation to settle transactions on DLT
Exchange of fiat to crypto or crypto to crypto	Non-discriminatory commercial policy, obligation to publish a firm price, execution at the price displayed at the time of receipt, transparency on orders and transactions.
Execution of orders	Best execution, clear information to clients on the execution policy
Placing of crypto-assets	Clear agreement with the issuer before the placing, specific rules on conflict of interest
Receipt of transmission of orders	Prompt transmission of orders, prohibition of non-monetary benefits, no misuse of information related to client's orders
Advice on crypto-assets	Necessary skills and knowledge, assessment of crypto-assets with the needs of clients.

Source: ESRB report on Crypto-assets and Decentralised finance, available here.

IOSCO notes further, in Recommendation no. 12, that the proper custody of client assets depends on the strength of a service provider's systems, policies and procedures. The arguably extensive, service-specific requirements under MiCAR should thus be welcomed in as much as these cover protection of client assets, reporting and record keeping of accounts, which IOSCO prioritises over matters on whether crypto-assets private keys are held in "hot" or "cold" or "warm" wallets.



Key considerations for crypto-asset Service Providers (CASPs) (4/7)

Compliance-Box (2): CASP organisational measures

Under MiCAR, CASPs are required to implement the following organisational measures

1	Members of the management body of CASPs shall have the necessary good repute and competence (i.e., qualifications, experience and skills), both individually and collectively, to perform their duties. They shall not have been convicted of offences relating to AML or terrorist financing or of any offences that would affect their good repute. They must be able to demonstrate that they are capable of committing sufficient time to effectively carry out their functions;
2	Shareholders and members, whether direct or indirect, that have qualifying holdings (i.e. above 10%) in CASPs shall be of sufficient good repute and shall not have been convicted of AML/ terrorist financing or of any other offences that would affect their good repute;
3	CASPs shall implement policies and procedures to ensure compliance with MiCAR. The management body of CASPs shall assess and review periodically the effectiveness of such arrangements, especially as to comply with the general and service-specific requirements and take appropriate measures to address any deficiencies;
4	CASPs shall employ personnel with knowledge, skills and expertise necessary to discharge the responsibilities allocated to them, taking into account the scale, nature and range of crypto-asset services provided;
5	CASPs shall establish a business continuity policy, which includes ICT business continuity plans as well as ICT response and recovery plans set up in accordance with DORA aimed at ensuring, in the case of interruption to their ICT systems and procedures, the preservation of essential data and functions and the maintenance of crypto-asset services or, where that is not possible, the timely recovery of such data and functions and the timely resumption of crypto-asset services;
6	CASPs shall have in place internal control mechanisms and effective procedures for risk assessment, including effective control and safeguarding arrangements to manage ICT systems in accordance with DORA. These internal control and risk assessment mechanisms shall be monitored and their adequacy and effectiveness be regularly evaluated as to which appropriate measures to address any deficiencies shall be taken;
7	CASPs shall have the systems and procedures to safeguard the availability, authenticity, integrity and confidentiality of information in accordance with DORA;
8	CASPs shall arrange for records to be kept of all crypto-asset services, activities, orders and transactions undertaken by them. These records shall be sufficient to enable NCAs to fulfil their supervisory tasks and to take enforcement measures, and in particular to ascertain whether crypto-asset service providers have complied with all obligations including those with respect to clients and market integrity. These records shall be kept for a period of five years and be provided to clients upon request, or, where requested by the NCAs before five years have lapsed, for a period of up to seven years;
9	CASPs shall notify their NCA, without delay, of any changes to their management body, prior to the exercise of activities by any new members and shall provide their NCA with all of the necessary information to assess compliance as stated in point 1 (above);
10	**CASPs safekeeping requirements mean CASPs must ensure:** • Adequate arrangements of safeguarding ownership rights of clients, especially in the event of insolvency, as well as to prevent the use of crypto-assets for their own account must be put in place for CASPs that hold crypto-assets belonging to clients or the means of access to such crypto-assets; • CASPs holding clients' funds other than EMT shall have adequate arrangements in place to safeguard the ownership rights of clients and prevent the use of client funds for their own account; • By the end of each business day following the day on which clients' funds other than EMTs were received, CASPs shall place those funds with a credit institution or a central bank; • CASPs shall take all necessary steps to ensure that clients' funds other than EMTs held with a credit institution, or a central bank are held in a separate account to the funds belonging to the CASPs; • Where payment services are provided, CASPs shall inform their clients of the nature and terms and conditions of those activities, including references to the applicable national law and to the rights of clients as well as whether those services are provided by them directly or by a third party;
11	CASPs shall maintain and operate an effective conflict of interest policy and ensure that the general nature and source of conflicts of interest and the steps taken to mitigate them are disclosed to (potential) clients on their website on a prominent place;
12	CASPs maintain robust policies and procedures which reduce the operational risk in the event of regulatory outsourcing of "operational functions"[34] as well as contingency and exit (i.e., insourcing).

[34] The reference to "just" operational functions differs to other EU financial services legislation and suggests that this may not include control functions. Notwithstanding the differing approach, regulatory outsourcing under MiCAR means that CASS firms shall remain "fully responsible for discharging all of their obligations and shall ensure that all the following conditions are complied with:

A. outsourcing does not result in the delegation of the responsibility of the CASPs;
B. outsourcing does not alter the relationship between the CASP and their clients, nor the obligations of the CASPs towards their clients;
C. outsourcing does not change the conditions for the authorization of the CASP;
D. third parties involved in the outsourcing cooperate with the competent authority of the CAS providers' home Member State and the outsourcing does not prevent the exercise of supervisory functions by those competent authorities, including on-site access to acquire any relevant information needed to fulfil those functions;
E. CASPs retain the expertise and resources necessary for evaluating the quality of the services provided, for supervising the outsourced services effectively and for managing the risks associated with the outsourcing on an ongoing basis;
F. CASPs have direct access to the relevant information of the outsourced services;
G. CASPs ensure that third parties involved in the outsourcing meet the standards laid down in the relevant data protection law which would apply if the third parties were established in the Union.

For the purposes of point (g), CAS are responsible for ensuring that the standards laid down in the relevant data protection legislation are set out in the written agreement that must be entered into with the outsourcing service provider. CASPs shall enter into a written agreement with any third parties involved in outsourcing. That written agreement shall specify the rights and obligations of both the CASPs and of the third parties concerned, and shall allow the CASPs concerned to terminate that agreement

Key considerations for crypto-asset Service Providers (CASPs) (5/7)

Compliance-Box (3): CASP service-specific measures (1/3)

1. When **operating a trading platform** for crypto-assets:
   - I. CASPs shall lay down, implement and maintain clear and transparent operating rules for the trading platform including at least;
     - A. The requirements, due diligence and approval processes applicable to admitting crypto-assets to the trading platform and the level of fees as well as the exclusion categories for those types of crypto-assets that will not be admitted to trading on the trading-platform including crypto-assets that have an inbuilt anonymisation function, unless the holders of those crypto-assets and their transaction history can be identified by the crypto-asset service providers operating a trading platform for crypto-assets. The operating rules shall clearly state that a crypto-asset is not admitted to trading where no corresponding 'white paper' has been published, save where exempted;
     - B. objective, non-discriminatory rules and proportionate criteria for participation in the trading activities, which promote fair and open access to the trading platform for clients willing to trade;
     - C. non-discretionary rules and procedures to ensure fair and orderly trading and objective criteria for the efficient execution of orders;
     - D. conditions for crypto-assets to remain accessible for trading, including liquidity thresholds and periodic disclosure requirements;
     - E. conditions under which trading of crypto-assets can be suspended;
     - F. procedures to ensure efficient settlement of both crypto-assets and funds;
   - II. Before admitting a crypto-asset to trading, CASPs shall ensure that the crypto-asset complies with the operating rules of the trading platform and shall assess the suitability of the crypto-asset concerned. When assessing the suitability, the CASP shall evaluate, in particular, the reliability of the technical solutions used and the potential association to illicit or fraudulent activities, taking into account the experience, track record and reputation of the issuer of those crypto-assets and its development team. The CASP operating a trading platform shall also assess the suitability of the crypto-assets other than ARTs and EMTs;
   - III. Where the operation of a trading platform for crypto-assets is provided in another member State, the operating rules shall be drawn up in an official language of the host member State, or in a language customary in the sphere of international finance;
   - IV. CASPs shall not deal on own account on the trading platform for crypto-assets they operate, including where they provide the exchange of crypto-assets for funds or other crypto-assets;
   - V. CASPs shall only be allowed to engage in matched principal trading where the client has consented to that process. They shall provide the NCA with information explaining their use of matched principal trading;
   - VI. Moreover, CASPs shall have in place systems, procedures and arrangements to ensure that their trading systems:
     - A. Are resilient;
     - B. Have sufficient capacity to deal with peak order and message volumes;
     - C. Are able to ensure orderly trading under conditions of severe market stress;
     - D. Are able to reject orders that exceed pre-determined volume and price thresholds or are clearly erroneous;
     - E. Are fully tested to ensure that the conditions under points a. to d. (above) are met;
     - F. Are subject to effective business continuity arrangements to ensure the continuity of their services if there is any failure of the trading system;
     - G. Are able to prevent or detect market abuse;
     - H. Are sufficiently robust to prevent their abuse for the purposes of money laundering or terrorist financing;
   - VII. CASPs shall inform their NCA when a case of (attempted) market abuse is identified occurring on or through their trading systems;
   - VIII. CASPs shall make public any bid and ask prices and the depth of trading interests at those prices which are advertised for crypto-assets through their trading platforms. The crypto-asset service providers concerned shall make that information available to the public on a continuous basis during trading hours. They shall make public the price, volume and time of the transactions executed in respect of crypto-assets traded on their trading platforms. They shall make those details for all such transactions public as close to real-time as technically possible. This information shall be made available to the public on a reasonable commercial basis and ensure non-discriminatory access to that information (i.e., in a machine-readable format at free of charge 15 minutes after publication and shall remain published for at least two years;
   - IX. CASPs shall initiate the final settlement of a crypto-asset transaction on the distributed ledger within 24 hours of the transaction being executed on the trading platform or, in the case of transactions settled outside the distributed ledger, by the closing of the day at the latest;
   - X. CASPs shall maintain resources and have back-up facilities in place to enable them to report to their NCA at all times; and
   - XI. CASPs shall keep at the disposal of the NCA, for at least five years, the relevant data relating to all orders in crypto-assets that are advertised through their systems, or give the NCA access to the order book so that the competent authority is able to monitor the trading activity. That relevant data shall contain the characteristics of the order, including those that link an order with the executed transactions that stem from that order.

2. When providing **exchange of crypto-assets for funds or other crypto-assets**:
   - I. CASPs have established a non-discriminatory commercial policy that indicates, in particular, the type of clients they agree to transact with and the conditions that shall be met by such clients;
   - II. CASPs shall publish a firm price of the crypto-assets or a method for determining the price of the crypto-assets that they propose to exchange for funds or other crypto-assets, and any applicable limit determined by that CASP on the amount to be exchanged;
   - III. Shall execute client orders at the prices displayed at the time when the order for exchange is final. CASPs shall inform their clients of the conditions for their order to be deemed final; and
   - IV. CASPs shall publish information about the transactions concluded by them, such as transaction volumes and prices.

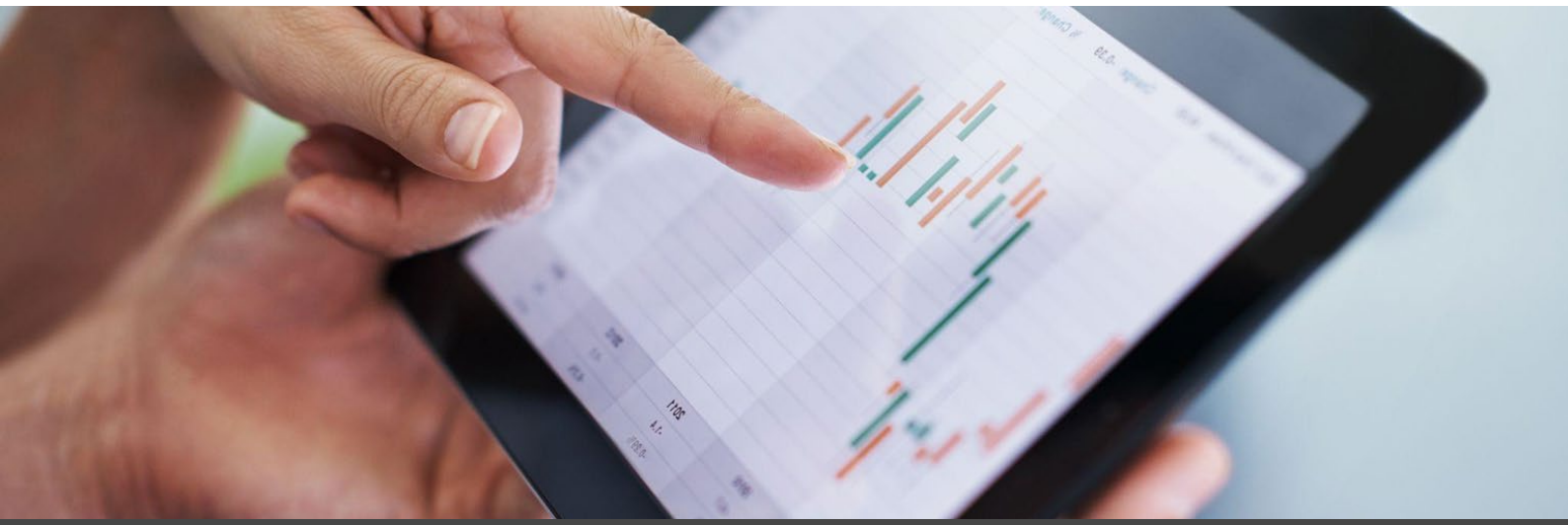
Key considerations for crypto-asset Service Providers (CASPs) (6/7)

Compliance-Box (3): CASP service-specific measures (2/3)

3. When **executing orders** for crypto-assets on behalf of clients:
   - I. CASPs shall take all necessary steps to obtain, while executing orders, the best possible result for their clients taking into account factors of price, cost, speed, likelihood of execution and settlement, size, nature, conditions of custody of the crypto-assets or any other consideration relevant to the execution of the order. This does not apply where CASPs execute orders for crypto-assets following specific instructions given by clients;
   - II. To ensure compliance with the above, CASPs shall establish and implement effective execution arrangements (i.e.an order execution policy) that shall provide, amongst others, for the prompt, fair and expeditious execution of client orders and prevent the misuse by the CASP employees of any information relating to client orders;
   - III. CASPs shall provide appropriate and clear information to their clients on their order execution arrangements and any significant changes thereto. That information shall explain clearly (in language and detail) how client orders are to be executed by CASPs. The latter shall obtain prior consent from each client regarding the order execution policy.
   - IV. CASPs shall be able to demonstrate to their clients, at their request, that they have executed their orders in accordance with their order execution policy and shall be able to demonstrate to the NCA, at the latter's request, their compliance with this Article;
   - V. Where the order execution policy, provides for the possibility that client orders might be executed outside a trading platform, CASPs shall inform their clients about that possibility and shall obtain the prior express consent before proceeding to execute their orders outside a trading platform, either in the form of a general agreement or with respect to individual transactions;
   - VI. CASPs shall monitor the effectiveness of their order execution arrangements in order to identify and, where appropriate, correct any deficiencies in that respect. CASPs shall assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for clients or whether they need to make changes to their order execution arrangements. CASPs shall notify clients with whom they have an ongoing client relationship of any material changes to their order execution arrangements.

4. When **placing crypto-assets**:
   - I. CASPs shall communicate the following information to the offeror, to the person seeking admission to trading, or to any third party acting on their behalf, before entering into an agreement with them;
     - A. The type of placement under consideration, including whether a minimum amount of purchase is guaranteed or not;
     - B. An indication of the amount of transaction fees associated with the proposed placing;
     - C. The likely timing, process and price for the proposed operation;
     - D. Information about the targeted purchasers
     - E. Before placing those crypto-assets, CASPs shall obtain the agreement fo the issuers of those crypto-assets or any third party acting on their behalf (as regards the information listed in points a. to d.).
   - II. CASPs rules on conflicts of interest referred to in Article 72(1) shall have specific and adequate procedures in place to identify, prevent, manage and disclose any conflicts of interest arising from the following situations:
     - A. Crypto-asset service providers place the crypto-assets with their own clients;
     - B. The proposed price for placing of crypto-assets has been over-/ underestimated;
     - C. Incentives, including non-monetary, are paid or granted by the offeror to CASPs.

5. Where they offer **reception and transmission** of orders for crypto-assets on behalf of clients:
   - III. CASPs shall establish and implement procedures and arrangements that provide for the prompt and proper transmission of client orders for execution on a trading platform for crypto-assets or to another CASP:
   - IV. CASPs shall not receive any remuneration, discount or non-monetary benefit in return for routing orders received from clients to particular trading platforms for crypto-assets or to another crypto-asset service provider;
   - V. CASPs shall not misuse information relating to pending client orders, and shall take all reasonable steps to prevent the misuse of such information by any of their employees.



Key considerations for crypto-asset Service Providers (CASPs) (7/7)

Compliance-Box (3): CASP service-specific measures (3/3)

6. Where **advice on and portfolio management** of crypto-assets is provided:
   - I. CASPs shall assess whether the crypto-asset service or crypto-assets are suitable for their (prospective) clients by taking into consideration their knowledge and expertise in investing crypto-assets, their investment objectives, including risk tolerance, and their financial situation including their ability to bear losses;
   - II. CASPs shall, in good time before providing advice on crypto-assets, inform prospective clients whether the advice is:
     - A. Provided independently
     - B. Based on a broad or on a more restricted analysis of different crypto-assets, including whether the advice is limited to crypto-assets issued or offered by entities having close links with the crypto-asset service provider or any other relationships that risk impairing the independence of the advice provided
   - III. And a CASP provides advice on crypto-assets informing the prospective client that advice is provided on an independent basis, it shall:
     - A. Assess a sufficient range of crypto-assets available on the market which must be sufficiently diverse to ensure that the client's investment objectives can be suitably met and which must not be limited to crypto-assets issued or provided by the same or closely linked CASPs;
     - B. But not accept and retain fees, commission or any other non-/monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation t the provision of the service to clients

Notwithstanding point b: minor non-monetary benefits that are capable of enhancing the quality of crypto-asset services provided to a client and that are of such a scale and natre that they do not impair compliance with a CASP's obligation to act in the best interest of its client shall be permitted in cases where they are clearly disclosed to the client;

   - IV. CASPs providing advice shall also provide prospective clients with information on all costs and related charges, including the cost of advice, where applicable, the cost of crypto-assets recommended or marketed to the client and how the client is permitted to pay for the crypto-assets, including any third-party payments.
   - V. CASPs providing portfolio management shall not accept and retain fees, commissions or any monetary or non-monetary benefits paid or provided by an issuer, offeror, person seeking admission t trading or any third party, or a person acting on behalf of a third party, in relation to the provision of portfolio management of crypto-assets to their clients;
   - VI. Where CASPs informs prospective client about advice being provided on a non-independent basis, that provider may receive inducements subject to the condition that it be clearly disclosed, in a comprehensive, accurate and understandable manner to the client and that the payment or benefit is:
     - A. Designed to enhance the quality of the service, and;
     - B. Does not impair compliance with the CASPs obligation to act honestly, fairly and professionally in accordance with the best interests of its clients:
   - VII. CASPs providing advice shall ensure that natural persons giving advice or information about crypto-assets, or a crypto-asset service, on their behalf possess the necessary knowledge and competence to fulfil their obligations. Member States will publish the criteria to be used for assessing knowledge and competence to this end;
   - VIII. For the purposes of the suitability assessment, CASPs shall obtain from their (prospective) clients the necessary information regarding the knowledge of, and experience in, investing, including in crypto-assets, their investment objectives, including risk tolerance, their financial situation including their ability to bear losses, and their basic understanding of the risks involved in purchasing crypto-assets, so as to enable CASPs to recommend to (prospective) clients whether or not the crypto-assets are suitable for them and, are in accordance with their risk tolerance and ability to bear losses.
   - IX. CASPs shall warn (prospective) clients that;
     - A. The value of crypto-assets might fluctuate;
     - B. The crypto-asset might be subject to full or partial losses;
     - C. The crypto-asset might not be liquid;
     - D. The crypto-assets are not covered by deposit guarantee schemes under Directive 2014/49/EU and, where applicable, by the investor compensation schemes under Directive 97/9/EC;
   - X. CASPs shall establish, maintain and implement policies and procedures to enable them to collect and assess all information necessary to conduct the above mentioned warnings;
   - XI. Where (prospective) clients do not provide information necessary to conduct the suitability assessment, CASPs shall not recommend such crypto-asset services or crypto-assets, nor begin the provision of portfolio management of crypto-assets;
   - XII. CASPs shall regularly review the suitability assessment every two years after the initial assessment made;
   - XIII. CASPs shall provide clients with a report, in electronic format, on suitability specifying the advice given and how that advice meets the preferences, objectives and other characteristics of clients and shall include at least;
     - A. An updated information on the suitability assessment (or review thereof); and
     - B. An outline of the advice given.

As the legislative process continues, on 12 July 2023, ESMA has published a first consultation paper on technical standards specifying certain requirements for CASPs under MiCAR. In particular the consultation paper relates to the content, forms and templates for the application for authorisation of CASPs, the complaint-handling procedure, the identification, prevention, management and disclosure of conflicts of interest by CAPs and the assessment of intended acquisition of qualifying holdings requirements. Further details on these draft technical standards are set out in further Client Alerts in this series.

Supervising CASPs and CAIs

Under MiCAR, NCAs will act as the front-line supervisors and enforcement agents of both CASPs and CAIs with the goal of ensuring compliance with the above regulatory requirements, the promotion of market integrity as well as consumer protection. NCAs will apply a modified supervisory toolbox including on-site and off-site inspections, thematic reviews, and regular supervisory dialogue to identify, monitor and request remedies to compliance in the shortcomings by CASPs and/ or CAIs.

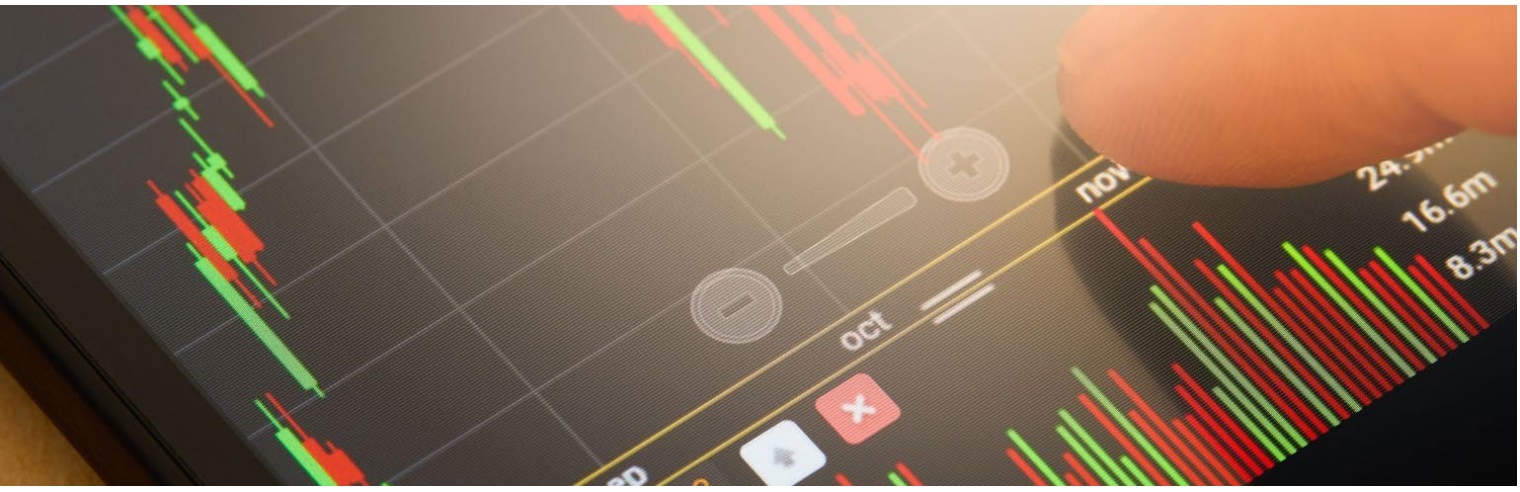
New enforcement powers include powers to suspend CAIs/CASPs offering activity; suspending advertisements and marketing activity; publishing public censures or notices that a CAI/CASP is failing compliance (e.g., a blacklist); require auditors or skilled persons to carry out targeted on-site and/ or off-site inspections of the CAI/ CASP, and/ or; issue monetary fines, other non-monetary sanctions and administrative measures to CAIS/ CASPs and/ or the members of management (including bans).

To this extent IOSCO calls for strengthened cross-border cooperation among regulators such as to arrange cooperation mechanisms to engage with regulators and relevant authorities in other jurisdictions. Such arrangements, it is recommended, should accommodate authorisation practices and ongoing supervision of regulated CASPs as well as enable broad assistance of enforcement investigations and related proceedings. As a matter of fact, besides the extensive investigative and sanctioning toolbox for NCAs, which MiCAR introduces cooperation mechanisms between authorities, including those in third countries. In similar fashion to other elements of MiCAR, the general approach to cooperation between authorities and the investigative and sanctioning toolbox, to be used by NCAs, reflects principles and the catalogue of penalties already embedded in EU financial law.

Supervisory responsibility of issuers of significant ARTs will fall on EBA while for issuers of significant EMTs supervisory responsibility will be shared by EBA and NCAs. In order to cover for the costs for executing its supervisory tasks relating to issuers of significant EMTs and ARTs, EBA has been granted powers to charge fees. In this regard, the Commission will adopt a delegated act by 30. June 2024 to further specify the type of fees, the matters for which fees are due, the amount of the fees and the manner in which they are to be paid and the methodology to calculate the maximum amount per issuer of significant EMTs/ARTs. To allow for monitoring whether an ART becomes used as a means of exchange, issuers are obliged to provide quarterly reports for ARTs with an issuance value above EUR 1 million. MiCAR also restricts the issuance of asset referenced tokens used widely as means of exchange. Issuers are required to stop further issuance where the estimate number and value of transactions per day associated with uses as means of exchange within a single currency area exceed 1 million transactions and EUR 200 million per day, respectively.

With respect to CASPs, MiCAR vests supervisory responsibility with the NCAs. Where CASPs have more than 15 million active users in the EU on average over a time period of 12 months they will be classified as significant CASPs. Although supervisory responsibility continues to be held by the relevant NCA, in such cases, ESMA must be kept informed by the latter on an ongoing basis about key supervisory developments.

Besides being able to issue opinions regarding supervisory convergence in the context of crypto-asset service providers, ESMA will be able to make use of its existing powers to ensure the orderly functioning and stability of the EU financial system with an emphasis on cross-jurisdictional dimensions. Upon legislative negotiations, the ECB has also been vested with veto rights with respect to stablecoins. CAIs issuing stablecoins will not only be required to maintain 1:1 reserves to cover all their claims and in order to satisfy redemption rights at all times, but the ECB may prohibit any issuance of stablecoins in respect of which it has concerns.



MiCAR's missing third country regime

Surprisingly, in contrast to existing EU financial markets regulation, MiCAR does not provide for a third country regime. This raises the question as to what possibilities MiCAR provides for third-country access to the single EU crypto market. Article 51 of MiCAR merely requires the Commission to comment in its evaluation report on whether MiCAR should, eventually, contain an equivalency rule for crypto service providers of crypto services from third countries, for which it would be necessary to be introduced via legislative proposal. catalogue of penalties already embedded in EU financial law.

In practice, persons located outside the EU are currently deprived of promoting their services to clients located in the EU. This requires full authorisation procedure, along with the remaining requirements necessary for becoming a MiCAR licenced CASP or CAI. At this stage, with MiCAR setting the global stage of crypto regulation, with many CASPs established in offshore financial centres and operating exotic structures, the supervisory and enforcement challenges may still be overly burdensome to overcome. Differing approaches of regulation across jurisdictions around the world might suggest a certain hesitation to open up the EU crypto-asset market to entities located in jurisdictions where said activities remain, if, at all, poorly regulated.

ESMA's forthcoming rulemaking in technical standards (1/2)

As detailed above, ESMA is required to finalise RTS on the following topics that have been set out in three consultation "packages":

1 **Package 1** – publication 12 July 2023 – deadline for consultation 20 September 2023 – covering:

1. The content of notification from selected entities to NCAs;
2. Forms and templates for notifications from entities to NCAs;
3. The content of the application for authorisation for CASPs;
4. Forms and templates for CASP authorisation applications;
5. Complaints-handling procedures;
6. Management and prevention as well as disclosure of conflicts of interest;
7. Intended acquisition information requirements;

2 **Package 2** – expected in October 2023 – covering:

8. Sustainability indicators;
9. Business continuity plan requirements;
10. Trade transparency data and order book record-keeping
11. Record-keeping requirements for CASPs;
12. Classification, templates and format of crypto-asset whitepapers;
13. Public disclosure of inside information;

3 **Package 3** – excepted in 1Q 2024– covering:

14. Qualification of crypto-assets as financial instruments;
15. Monitoring, detection and notification of market abuse;
16. Investor protection rules;
17. Reverse solicitation rules;
18. Suitability rules on advice and portfolio management services to the client;
19. Policies and procedures for crypto-asset transfer services including clients' rights; and
20. Rules on system resilience and security access protocols.

Details of the above are set out in standalone coverage from our EU RegCORE in this series.

EBA's forthcoming rulemaking in technical standards (2/2)

Besides the novel supervisory tasks for ARTs and EMTs that are determined to be significant, EBA is likewise mandated to develop a set of technical standards and guidelines under MiCAR to further specify the requirements for ARTs and EMTs as well as to produce regulatory products jointly with ESMA and also with EIOPA:

1

Package 1 – publication on 12 July 2023 – deadline for consultation on 12 October 2023 – covering:

- ART authorisations;
- Qualifying holdings; and complaints handling

2

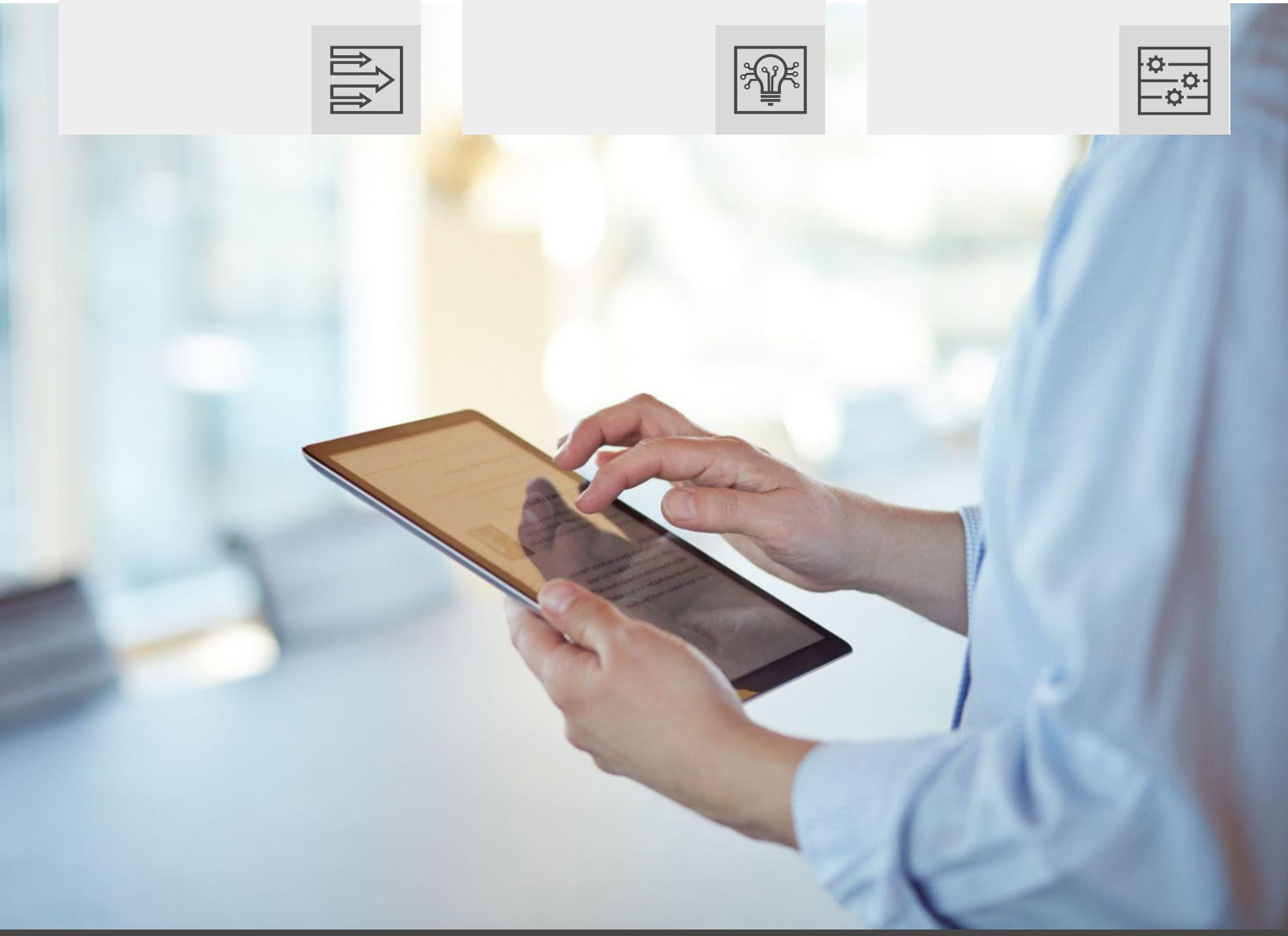
Package 2– publication scheduled in Q3 2023 – covering:

- Mandates on the approval of ART whitepapers (for tokens issued by credit institutions); and
- Suitability of members of the management body of ART issuers and CASPs

3

Package 3 – publication scheduled before the end of 2023 – covering, amongst others:

- Prudential mandates.



Further comments and open questions on crypto-asset services (1/3)

The point in time at which MiCAR is taking the stage is certainly fitting although a number of questions remain non exhaustively addressed – and may not be covered by further details in final versions of RTS/ITS. These are presumably to be seen as the flip side of what is, certainly vis-à-vis its international lawmakers, a rapid legislative endeavour of following through with said chapter in the Single European Rulebook. The co-legislators appear to have performed a regulatory triage of what currently sufficiently resembles traditional financial services activities such as to be able to adopt many of the existing regulatory approaches, while leaving open the regulation of those activities still at an infant stage and as to which the application of current rules would be inadequate. For this purpose, MiCAR expressly tasks the Commission jointly with EBA and ESMA to report to the EP and Council on the status quo of technological developments in the market such as to eventually perform a major overhaul and extend the scope of MiCAR allowing it to maintain its technology agnostic nature going forward.[35]

- **Decentralised Finance**:

  Although partially decentralised services may fall within the scope of MiCAR, where an activity is deemed fully decentralised and without intermediary MiCAR will not be applicable. As expressly stated in Article 142(2)(a) MiCAR is not blind to this ambiguity in that it anticipates technological progress in this area and vouches for reports on the appropriate regulatory treatment of decentralised crypto-asset systems.

- **Non-Fungible Tokens (NFTs)**:

  As missing clarity on the terminology currently persists, NFTs are seemingly exempt from the scope of MiCAR. This is because the delineation between crypto-assets covered by the scope of MiCAR/ existing EU financial regulation and those tokens that are “unique” and “not fungible with other crypto-assets” remains unclear. As such, market participants will likely be confronted with the limits of such ambiguous differentiation between regulated and non-regulated products. Recitals 10 and 11 underline the concept of “substance over form” in this regard clarifying that simply naming a token an NFT will currently not suffice to this end. The recitals provide for a “valuation test” to determine whether an NFT’s valuation depends on that of a comparable crypto-asset with similar features such that it would be rendered fungible and correspondingly qualify as an instrument which is not exempted from MiCAR.

- **Crypto lending and staking:**

  MiCAR does not specify whether crypto-asset based lending is a regulated activity. This may be regulated at the national level or lending activities involving crypto-assets may be undertaken in the context of a lender performing other related activities, triggering MiCAR’s authorisation requirements. Yield and interest rates are, however, prohibited under MiCAR for the purpose of which discounts, rewards or compensation for holding EMTs will be considered as offering interest.

  Naturally, if a digital asset is categorised as a financial instrument, in view of the terminology as described above, lending of financial instruments is governed by the existing body of EU financial services legislative and regulatory requirements. This is likely to be the case where crypto lending covers title transfer such that it bears more resemblance to securities lending as opposed to cash-based lending. Indeed, where the crypto-asset in question falls under the definition of transferable security, existing EU financial services laws (such as the EU’s Securities Financing Transactions Regulation) will apply to such lending activity, and the servicing of transactions will require prior authorisation as MiFID II firm.

  It is desirable to consider the approach of the SEC and developments in the US for a comparative perspective in this context. The notion of a security is based under US law on the *Howey* test, defining an investment agreement as “an investment of money in a common enterprise with profits to come solely from the efforts of others”. It follows, where courts determine that a crypto-asset is captured by the US definition for a security, a crypto-asset based lending arrangement would presumably become subject to regulatory requirements and obligations associated with traditional securities offerings under U.S. Accordingly, the SEC distinguishes between a replacement currency (i.e., a medium of exchange) and mere “tokens”. As an example, in practice, however, the SEC classified BlockFi’s ‘Earn Programme’ as securities since “investors in the BIAs [BlockFi Interest Accounts] had a reasonable expectation of obtaining a future profit from BlockFi’s efforts in managing the BIAs based on BlockFi’s statements about how it would generate the yield to pay BIA investors interest” and that “investors would share profits in the form of interest payments resulting from BlockFi’s efforts”. Going forward, however, it is fair to assume that this structure and approach to regulating crypto-asset based lending will create considerable uncertainty in as much as future, more exotic products will be confronted with said legacy test.

[35] See Article 142(1) MiCAR

Further comments and open questions on crypto-asset services (2/3)

- **Custodian business in Germany**:

  Crypto-asset custodians in Germany are currently not regulated as securities institutions within the meaning of the *Wertpapierinstitutsgesetz* (WpIG) but as financial services institutions via the *Kreditwesengesetz* (KWG). This causes friction in relation to the regime now introduced by MiCAR. Crypto-asset custodians are subject to a special regulation of the German legislator the origins of which are not connected to EU financial law. It is hence unclear whether custodians in Germany will be able to claim the exemption for investment firms introduced in MiCAR. In as much as the German legislator has excluded units of account and cryptocurrencies from the business of custody and administration, it could appear that the exception provided under MiCAR does not apply to German crypto custodians.

  It is worth mentioning that, according to the principles of EU law, the body of EU financial law is superior to national law and the latter cannot be used to interpret EU regulations in any case. On a similar note, it may be argued that a German-licensed crypto custodian will have better cards in fulfilling supervisory requirements for crypto custody enshrined in MiCAR compared to securities institutions that also hold financial instruments in custody as an ancillary service. It remains to be seen which position BaFin will take in this context as the time until MiCAR's applicability commences starts running.

- **Tax treatment:**

  While MiCAR is silent on tax treatment, the question remains on what changes are needed in order to complement the MiCAR regime so as to effectively combat tax evasion. Currently, the tax treatment of crypto-assets falling within the scope of MiCAR as well as those falling within the scope of MiFIR/MiFID II could imply that these assets remain subject to possible further fragmentation, in that there might arise differing interpretations across Member States. As a matter of fact, the current tax treatment of crypto-assets varies substantially across the EU. Some countries have introduced specific legislation[36] while others, notably Germany, have signaled an unlikelihood of introducing crypto-asset specific tax frameworks. Instead, the Federal Ministry of Finance (**BMF**) has published a circular in May 2022 describing the tax treatment of crypto-assets and the applicable pertinent fundamental tax rules.

  In addition, on 14.2.2023 a judgment was made before the Federal Fiscal Court (**BFH**)[37], which is of particular interest to private individuals, as it was decided that cryptocurrencies are also to be classified as an asset under German tax law, and therefore the basic rules of section 23 para. 1 sentence 1 no. 2 GITA (German Income Tax Act) apply and consequently represent a private sale transaction if certain holding periods are not observed. In the future, private individuals may well be affected by various reporting obligations (i.e., CARF and DAC 8). Correspondingly, this issue may well limit the way in which the level playing playing-field envisaged by MiCAR is applied in practice.

- **Scope of tokens:**

  as the crypto-assets marketplace continues to evolve, so will the form and nature of tokens. The current delineation provided by the scope of MiCAR will likely become strained moving forward. As mentioned also in the study requested by ECON, MiCAR has equipped itself with a set of mechanisms and tools that allows for some degree of flexibility to this end, including, among others, granting ESMA powers to provide guidelines regarding the criteria and conditions for the qualification of crypto-assets as financial instruments. Moreover, guidelines jointly developed by the ESAs which include a template for the explanation, opinion and a standardised test for the classification of crypto-assets allow for further consistency in legal opinions.

[36] i.e. Cyprus

[37] file reference: IX R 3/22

Further comments and open questions on crypto-asset services (3/3)

- **Decentralised Autonomous Organisation (DAOs):**

  Against the background of a necessary presence across the EU also for DeFi, it is unclear how MiCAR will practically apply to DAOs. It cannot be excluded that the geographical presence requirement will place digital assets into three categories: (i) regulated under exiting EU financial law; (ii) regulated under MiCAR and (iii) unregulated. The significance of such uncertainty in the EU is not a recent issue and has been addressed by international bodies already in 2020.[38]

  In addition to the above, MiCAR currently also has the following "missing" clarity on the following issues related to the crypto-assets transactions themselves:

- **Atomic swaps:**

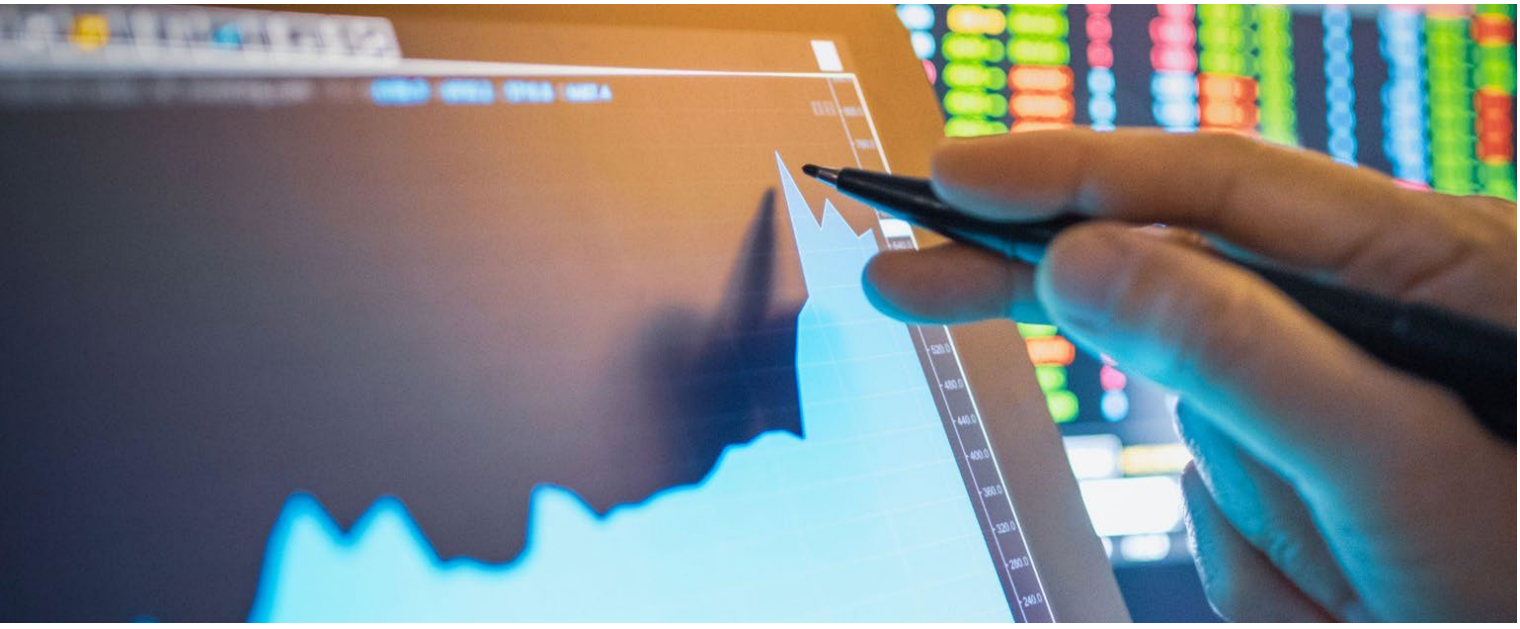
  refers to the process, using a smart contract, or other mechanism that facilitates the simultaneous exchange of one crypto-asset for another without using a centralised exchange but rather, which may occur on an off-chain or cross-chain basis;

- **Double spending**:

  as has been pointed out by the ECB[39], some distributed ledgers do not use double-entry bookkeeping but use single-entry bookkeeping resorting to cryptographic linkages that call into question the role of an issuance or distribution account and the role as well as correct nature of performance of any automated notary function which checks the correspondence between the issued amount of securities in an issuance account and the total amount of tokens credited; and

- **MiCAR does not prescribe a definite accounting or bookkeeping approach of CAIs:**

  As the study requested by ECON notes, this has proven to be of paramount importance in case of winding up a platform in the worst case of insolvency of an offeror. As a further point of divergence, it should be noted that MiCAR provides governance arrangements which include accounting rules for ART issuers, but do not extend these requirements to EMT issuers as well as issuers of other crypto-asset providers. On this note IOSCO Recommendation no. 18 for issuers stands in contrast in as much as accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable standard.



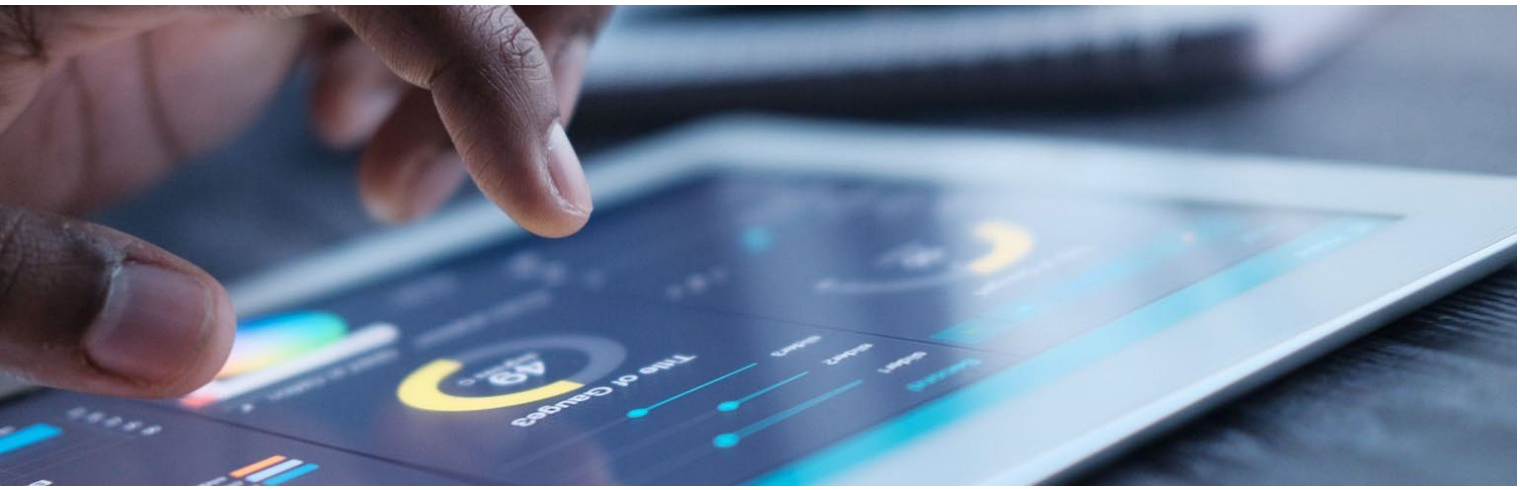
[38] See International Organization of Securities Commissions (2020), here

[39] Available here, p.40

Key impacts on persons affected under the MiCAR regime

While a technology neutral and jurisdiction agnostic regulatory framework will certainly yield many benefits going forward, taken together, the impact left by this latest addition to the EU's Single Rulebook will be far-reaching and influence many market participants. The Commission concedes that initial costs will undoubtedly arise to accommodate the regime smoothly. While does not exclude the potential market-exit of some participants, it underlines that longer term benefits will outweigh initial issues. The below table identifies some of the key impacts ahead:

Type of firm affected	Summary of MiCARs likely main impact
CASPs	The type of firms that would, under MiCAR, qualify as a CASP have thus far been operating in the regulatory void. As described above, MiCAR introduces a new authorisation and ongoing operational and compliance framework, in addition to costs, depending on the type of activities in question. CASPs providing trading platforms will become subject to a new licensing requirement as well as new on-going compliance and operational costs. MiCAR, however, introduces this regime on a harmonised basis across the entirety of the EU, meaning that there is a greater playing field for the provision of services. The economies of scale expected from the establishment of this single EU crypto-asset market is precisely what the Commission points to when weighing imminent, albeit short-term costs, with future benefits. Until then, as confirmed by the Commission, even CASPs such as platforms, which have taken certain steps to become aligned with the new regime will have further work to do.
CAIs	The type of firms that, under MiCAR, will fall under the definition of crypto-asset issuers will have to prepare for rising compliance costs, in as much as mandatory transparency and disclosure requirements will become due. Naturally, the introduction of the whitepaper, as well as the standardisation of its content and those specific to the type of token issued will also have to be faced.
Investors	Clients of crypto-asset services are certainly winners in this new regime. MiCAR will introduce a set of increased investor protection rules as well as market integrity provisions which collectively reduce the risks, certainly making the EU crypto-asset marketplace a worldwide benchmark in terms of investor friendliness.



Mastering MiCAR – key next steps (1/3)

MiCAR published in the OJ	MiCAR entry into force	Stablecoin date of application	FULL application date of MiCAR
09 June 2023	**30 June 2023**	**30 June 2024**	**30 December 2024**
Publication of MiCAR's final text in the Official Journal marks the conclusion of the legislative process and introduces a new chapter into the EU's Single Rulebook.	The Regulation came into force on the 20th day after its publication in the OJ	The provisions in Titles III and IV regarding ARTs and EMTs will begin to apply already 12 months after entry into force	The remaining provisions of Titles I, II, V, VI and VII will apply 18 months after entry into force as transitional measures end and Member States will have implemented MiCAR in its entirety.

As the clock for provisional measures started ticking at the end of June, market participants are advised to perform a detailed review of activities in the crypto-assets area to evaluate whether implementation of MiCAR will impact their regulatory compliance. As sitting still and waiting for application of various Titles of MiCAR is not an option, **PwC Legal's EU RegCORE** provides assistance on, and advises participants to proceed with the following agenda.

Market Participants should Identify & Review		
By December 2023	**Activities**	**Market participants should reflect on their own activities and business models and whether:** 1. these are captured by MiCAR?; 2. they fall into traditional financial services legislation – and whether a license is required?; or 3. they are not regulated at all?
	Customers	**Market participants should:** 1. reflect on their counterparty, client and/or customer base (professional/ retail); and 2. the different activities carried out respectively for such persons.
	Regulatory Engagement	Market participants should review and track where activities are currently carried out from – already based in EEA and where such activity is required to be limited due to third-country restrictions warranting disclaimers to meet relevant third country regulatory requirements.
	Geography	Some market participants may be facing regulatory engagement for the first time or much stricter supervisory expectations than previously accustomed to and may want to identify which regulators in the EEA jurisdictions become relevant.
	Grandfathering	Market participants with MiFID II authorisations benefit from transitional provisions – they will be able to continue conducting business under MiCAR without having to obtain a separate license under MiCAR where the provision of such crypto asset services are equivalent to those for which a license has already been granted under MiFID II. To this end, MiCAR includes a list of which services are deemed equivalent. As such market participants will be able to grandfather registration done with an EEA competent authority prior to December 2024.

Mastering MiCAR – key next steps (2/3)

Market Participants should consider:		
By June 2023	**Stablecoins**	**How will the regime on ARTs and EMTs affect them. NOTE: it applies earlier than remaining provisions.**
	Level 2 legislation	**How the level 2 legislation will impact them, as the regulatory framework under MiCAR is open to flexibility going forward.**
	Token Categorisation	**How the crypto assets envisaged for issuance would be categorised, if at all, under MiCAR;** 1. Asset-referenced tokens (ARTs) 2. Electronic money tokens (EMTs) 3. Other crypto-assets
	Whitepaper Requirements	Which assets they will be able to list, and whether any whitepaper obligations apply under MiCAR. How do you set up a whitepaper?
	Fast-Track Procedures	How to convert an AML registration into a MiCAR authorisation given divergence in how national competent authorities will handle this.
	Custody and Liquidity	Whether the arrangements and source of liquidity are possible. Is the custody of crypto assets also considered?
	Jurisdiction	Which jurisdiction to choose. This choice should include considerations of regulatory requirements (i.e., workforce and grandfathering options provided) as well as timing and tax.

Mastering MiCAR – key next steps (3/3)

Market Participants should prepare:		
By December 2024	**MiCAR license application**	Necessary documentation and requirements for registration application with competent authorities should be prepared ideally well in advance to start operating as soon as possible once application windows open.
	Prudential Requirements	It is essential that sufficient capital will be in place. Market participants should therefore know which prudential requirements apply for the respective authorisation sought.
	Group Structure	Market participants will want to have worked out which group structure is most suitable and whether it requires incorporating new subsidiaries or setting up new branches.
	Compliance Requirements	Market participants should thoroughly have reviewed their compliance requirements prior to full entry into application of MiCAR – 30 December 2024.
	Grandfathering compliance	Market participants will also want to have prepared a plan on how to bridge the transitional period while passporting becomes possible only with full MiCAR license: what about marketing and reverse-solicitation?

Outlook and next steps

The paradigm shift introduced by MiCAR remains undisputed as it fills the regulatory vacuum outside of existing EU financial regulation and establishes a comprehensive regulatory framework for the crypto-asset marketplace. As the crypto universe continues to evolve, MiCAR has provided itself and regulators with flexibility such as to respond to ongoing and material developments. Specifically, ESMA along with the EBA have been empowered to issue guidelines on criteria and conditions for the qualification of crypto-assets as financial instruments such as to mitigate potential future tensions arising between MiFIR/MiFID II plus IFR/IFD and MiCAR. This is complemented by delegated acts, which the Commission may adopt regarding the specification of technical aspects of terminology. As the first provisions of MiCAR are set to apply in the summer of 2024, the ESAs will jointly issue an annual report concerning recurring issues and difficulties as well as divergences in the approaches of NCAs to enforce and supervise this new regime.

The expansion of the EU's single rulebook for financial regulation is making a considerable leap forward with the implementation of MiCAR. While it proves the effectiveness of existing EU financial regulation as evidenced in the many principles and approaches borrowed and mirrored in MiCAR, it contributes to expanding the scope and relevance of top-down rulemaking by single-handedly establishing a level playing field for what is yet an emerging technology, the benefits of which are yet to fully unfold. On this road, MiCAR lends regulators and private market actors to follow clear boundaries, while protecting EU market participants specifically citizens, in an effort to completing CMU step by step.

At this stage, market participants are advised to perform a detailed review of their activities in the area of crypto in order to evaluate whether the implementation of MiCAR is likely to impact the set of EU financial legislative and regulatory requirements relevant persons must currently adhere to and whether substantial measures will be required in order to ensure continuing compliance. To find out more on how to prepare for MiCAR, how to navigate challenges and seize opportunities, please refer to our further Client Alerts and Background Briefings on MiCAR as well as related coverage form our EU RegCORE's series on the EU's Digital Single Market, financial services and crypto-assets more broadly (here).

About us

PwC Legal together with PwC is assisting a number of financial services firms and market participants in forward planning for changes stemming from relevant related developments. We have assembled a multi-disciplinary and multijurisdictional team of sector experts to support clients navigate challenges and seize opportunities as well as to proactively engage with their market stakeholders and regulators.

Moreover, we have developed a number of RegTech and SupTech tools for supervised firms, including PwC Legal's **Rule Scanner** tool, backed by a trusted set of managed solutions from PwC Legal Business Solutions, allowing for horizon scanning and risk mapping of all legislative and regulatory developments as well as sanctions and fines from more than 750 legislative and regulatory policymakers and other industry voices in over 170 jurisdictions impacting financial services firms and their business.

Furthermore, in leveraging our Rule Scanner technology, we offer a further solution for clients to digitise financial services firms' relevant internal policies and procedures, create a comprehensive documentation inventory with an established documentation hierarchy and embedded glossary that has version control over a defined backward plus forward-looking timeline. This thereby allows changes in one policy to be carried through over to other policy and procedure documents, tracking of critical path dependencies and mapping of legislative and regulatory developments and flagging where these may require actions to be taken in such policies and procedures.

If you would like to discuss any of the developments mentioned above, or how they may affect your business more generally, please contact any of our key contacts or PwC Legal's RegCORE Team via de_regcore@pwc.com. Further details on PwC Legal and PwC's crypto-asset capabilities and servicing offering in Europe is also available on our website.

Dr. Michael Huertas

Tel.: +49 160 973 757-60

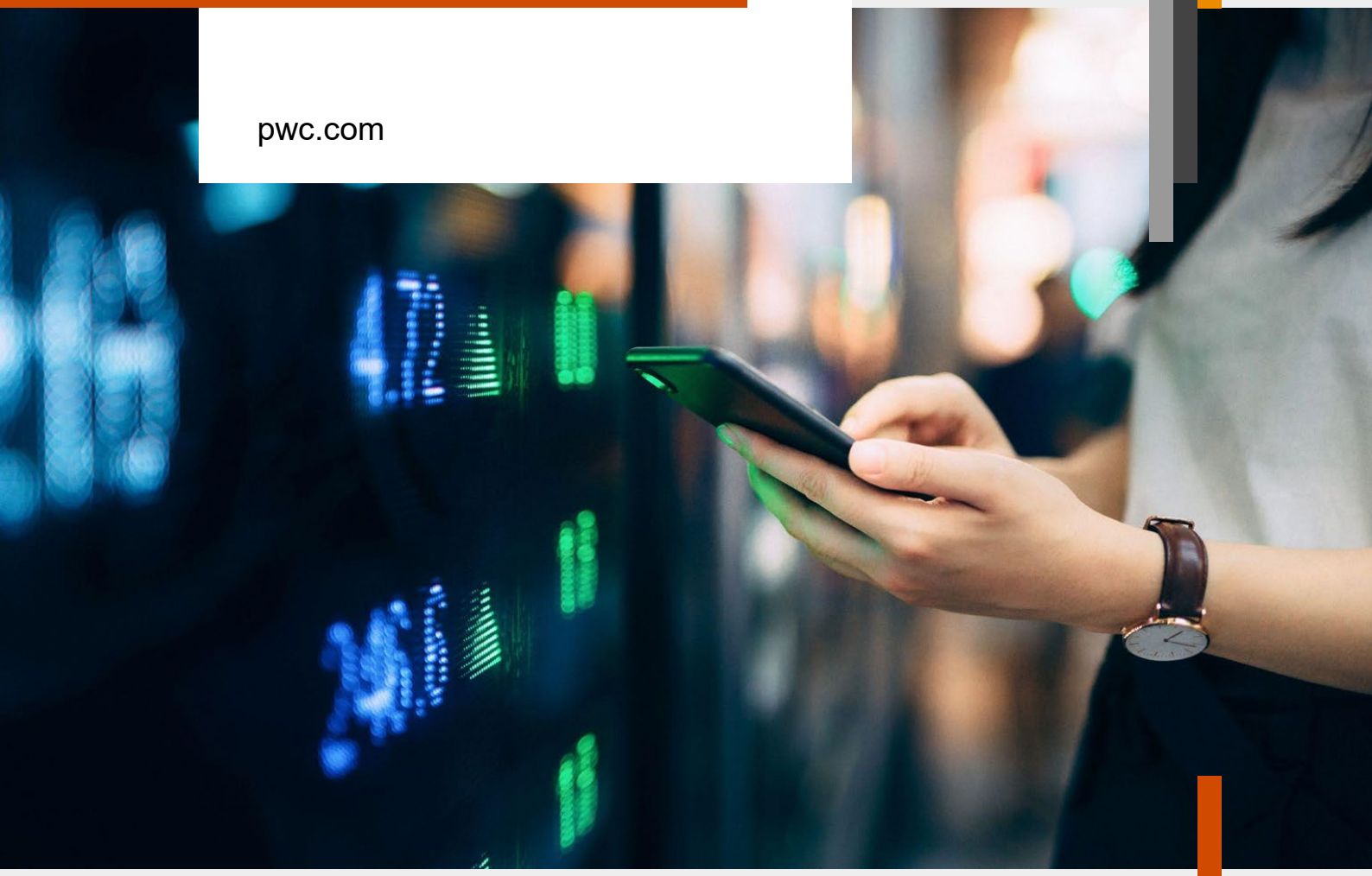
michael.huertas@pwc.com

Andreas Traum

Tel.: +49 30 26363820

andreas.traum@pwc.com

pwc.com



pwc