Markets in Crypto-Assets

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The advent of digital currencies has spurred global regulators into action in recent years, leading to growing debate on central bank digital currencies [1], increasing regulation, a plethora of reports pondering the various threats and opportunities these currencies create, and considerable questions regarding the role of the State and monetary sovereignty in the 21st century. As part of its Digital Finance Package, the European Commission released its own legislative proposal concerning crypto-assets on 22 September 2020. The proposed framework, commonly referred to as the Markets in Crypto-Assets Regulation [2] or MiCA, aims to support innovation within EU financial markets while upholding standards concerning consumer protection, market integrity, financial stability, monetary policy transmission, and monetary sovereignty. Primarily aimed at crypto-currency service providers and so-called stablecoins, the proposal seeks to balance the need for legal certainty with the limited efficacy of regulating highly mobile assets in a globalised, digital world.

Crypto-assets

Crypto-currency is often described as a digital or virtual currency that relies on cryptography to prove ownership and protect the integrity of transaction records. The typical use of a decentralised governance model, whereby control is distributed away from a central authority, is one of the aspects that sets it apart from more traditional e-money. The infrastructure supporting this model is called distributed ledger technology (DLT), often in the form of a blockchain. Since the launch of Bitcoin in 2009, crypto-currencies have really taken off across the world in various forms with a market cap reportedly exceeding $ 1 trillion [3] in 2021.

As an increasing number of asset managers and financial institutions are now willing to develop or invest in crypto-assets, which may result in a prominent role for this asset class in the future. Macro-economic developments such as global monetary and fiscal policy, as well as rising government debt are suspected of fuelling this rise by some analysts, with some investment banks speculating that crypto-currency could even take the place of gold as the favoured hedge against inflation by sceptics, or perhaps even gain the coveted status of world reserve currency [4].

Attempting to circumvent the volatility often seen in traditional crypto-currencies such as Bitcoin, stablecoins in particular could be more likely to grow into a global currency with widespread use. While anonymity and lack of

1 See next thematic article “Analysing a digital euro – A status update”.
2 Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-Assets, and amending Directive (EU) 2019/1937.
3 According to data released by CoinGecko and reported in various media outlets.
4 Ruchir Sharma, global chief strategist for Morgan Stanley, FT opinion piece: https://www.ft.com/content/ea33b688-12e0-459c-80c5-2efba58e6f1a.

data preclude any definitive causes or explanations, the mere possibility of attaining economic prominence, and the risks this entails, among financial institutions and consumers forms an adequate impetus for regulators to step in.

MiCA casts a wide net in terms of definition of crypto-assets in its current form, defining these as *a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology*. While the draft Regulation covers any crypto-assets that are not yet regulated by other legislative instruments, the main focus of the proposal is on stablecoins. Noting the impossibility ofguaranteeing a truly stable value, the proposal splits these into categories based on the underlying assets: electronic money tokens (EMTs) and asset-referenced tokens (ARTs). If the proposal is adopted, crypto-assets other than EMTs/ARTs[1] will benefit from a 'light' regime, subject to simple notification of the relevant NCA rather than *ex-ante* approval. Under this regime, exemptions for small offers[2], offers made only to qualified investors, unique and non-fungible crypto-assets, and crypto-assets merely for use as support for a DLT platform would bring a lighter regulatory touch. A grandfathering clause would be included, exempting any existing crypto-assets in this category from having to comply with title II provisions[3]. Common to all these categories is the requirement of a crypto-asset white paper, detailing the business and technical details of the proposed crypto-currency. Regardless of supervision[4], any issuer would be liable for any losses resulting from impropriety in these white papers, and held to honest, fair and professional standards so as to ensure consumer protection.

E-money tokens

"Electronic money tokens" are a tokenised version of e-money, which are intended to be used primarily as a means of payment. In practice, these would be subject to the same regulatory requirements of EMD2[5], while slightly expanding the definition as to avoid regulatory arbitrage. In order to issue an EMT, authorisation as a credit institution or electronic money institution will be a prerequisite. Issuance and redemption will be required at par value, along with stringent rules in terms of consumer protection, civil liability and asset segregation. The offering of interest on any EMT will be prohibited as well, according to current rules. EMTs can only be issued or offered to the public within the EU subject to these rules. Any EMT denominated in euro or another official currency of the European Union[6] will automatically be assumed to be offered within the EU.

Asset-referenced tokens

Asset-referenced tokens are defined in the draft Regulation as a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or any combination these assets. Compared to EMTs, ARTs are to be authorised through a stricter procedure, as outlined in Article 15 *et al.* of the proposal[7]. Of major importance is the legal opinion that these assets do not qualify as financial instruments or other regulated activities. Considering the

1 This is a catch-all definition, including any crypto-asset except for those designated as ART or EMT.

2 Fewer than 150 investors or € 1 million.

3 This primarily entails crypto-asset white paper and marketing communications requirements.

4 NCAs will perform any notification, authorisation and supervisory duties, except where specifically stated otherwise.

5 Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (Electronic Money Directive or EMD2).

6 Including the Bulgarian lev, Croatian kuna, Czech koruna, Danish krone, Hungarian forint, Polish złoty, Romanian leu, Swedish krona, Swiss franc (in parts of Italy and Germany), and Turkish lira (Cyprus).

7 Including an extensive white paper, containing a description of the issuer's governance arrangements, the reserve of assets, the custody arrangements, the investment policy of the reserve and the rights granted to the holders.

sheer scope of possibilities covered under the ART definition, the challenge lies in regulating activities that have yet to materialise. In response to this, NCAs can refuse authorisation to any issuer where there is a serious risk to financial stability, monetary policy transmission or monetary sovereignty.

Significant EMTs & ARTs

A separate supervisory regime is foreseen for those EMTs and ARTs that are considered to be significant. Classification of one of these crypto-assets is possible at the time of application or upon reaching the thresholds set out in the relevant articles, or at the request of either the issuer or the EBA.

The criteria that will be considered under the MiCA Regulation are the following[1]:

- size of customer base of the asset-referenced token promoters;
- value of asset-referenced tokens/market capitalisation;
- size of the reserve of assets;
- significance of cross-border activity including use for cross-border payments/remittances;
- interconnectedness with financial system.

Additional rules are applicable for any ART or EMT classified as significant, such as higher own funds requirements. Specific rules for ARTs include further interoperability requirements, as well as more thorough liquidity management policies in order to withstand liquidity stress scenarios and renumeration policies that reduce any incentive to relax risk standards. Supervision would be carried out by the EBA in collaboration with a college of supervisors. Significant EMTs, on the other hand, will be subject to addition requirements regarding custody and investment of reserve assets, as well as an orderly wind-down plan. They will have a dual supervisory regime performed by both NCAs and the EBA, also collaborating with the college of supervisors.

Service providers

Acting as a gateway to the financial system, crypto-asset service providers are considered essential in implementing existing regulations in the crypto-sphere. Compliance with rules regarding issuance and offerings to the public are effectively prerequisites for admittance to trading platforms or exchanges.

Typical examples of this category include trading venues, execution and placement, reception and transmission of orders, and advisory services. Drawing upon experience with similar (regulated) services, various rules will be imposed with regard to transparency, consumer protection, conflicts of interest, asset segregation and liability.

Timing

According to the Digital Finance Strategy, the European Commission is hoping that MiCA will enter fully into force by 2024. Allowing for a period of 18 months after entry into force, to complete the necessary RTS, the full proposal would need to be finalised by June 2022.

1 As presented by the EU Commission on 20 September 2020.