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CRYPTO-ASSETS;

Becoming a regular asset class?

Dr. Christian Storck, Linklaters LLP, Partner, Capital Markets, gives a detailed breakdown of planned crypto-asset regulation in the EU.

In popular discourse, crypto-assets are often reduced to cryptocurrencies, bitcoin and blockchain. Surely, this is short sighted. As with any classification, the purpose of the definitions drives their scope.

The broadest interpretation is looking at the technology, from this perspective any deployment of decentralised ledger technology (DLT) could be seen as crypto and if the relevant token references an asset or is itself an asset, it qualifies as such. However, as a lawyer, I look at the regulatory framework and see how crypto assets are defined therein.

And it's no surprise the European Commission has proposed regulating the entire crypto industry by 2024 with the introduction of the Markets in Cryptoassets Regulation (MiCAR) setting separate issuance frameworks for three categories of crypto-assets: e-money tokens, asset-referenced tokens and other crypto-assets. MiCAR will also impose obligations on providers of crypto-asset services; custody, operating a trading platform, exchange, execution of orders, placing, reception and transmission, and providing advice or portfolio management. In-scope crypto-asset service providers will need to comply with conduct regulations, prudential safeguards, organisational requirements, safeguarding rules, complaints-handling procedures, manage conflicts of interest and outsourcing rules.

Why regulate crypto-assets?

As markets in crypto-assets have evolved, authorities across the world have been prompted to consider whether there are unintentional gaps in existing regulatory frameworks that ought to be closed. A lack of legal certainty has also been seen as a barrier to safe innovation in digital finance. EU authorities have been further concerned that differing national responses may lead to fragmentation within the single market.

MiCAR is Europe's answer to these issues and has been developed off the back of a public consultation. It seeks to establish a harmonised EU regime for the regulation of crypto-assets. The trilogue consultation has started and is likely to continue for the rest of 2022.

The intention is for the new regime to be directly applicable in all EU Member States, replacing existing national frameworks applicable to crypto-assets. This will inevitably raise questions for some national regulators in relation to the transition process and the treatment of entities approved under existing regimes.

Scope of the new regulation

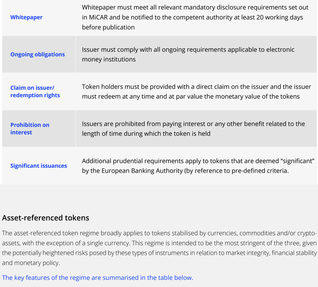
MiCAR casts a wide net, defining the term "crypto-asset" very broadly as "a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology". However, it seeks to avoid regulatory overlap (at an EU-level) by carving out crypto-assets that are otherwise regulated as financial instruments, e-money (except where they qualify as e-money tokens under MiCAR), deposits, structured deposits or securitisations.

In relation to in-scope crypto-assets, MiCAR covers:

- the regulation of crypto-assets to be offered to the public or admitted to trading on a trading platform in the EU
- the regulation of crypto-asset service providers
- a market abuse regime for crypto-assets admitted to trading on a trading platform operated by a crypto-asset service provider
- a mechanism for the oversight of material acquisitions in respect of issuers of asset-referenced tokens (as defined below) and crypto-asset service providers.

So, what is a crypto-asset?

MiCAR establishes separate frameworks in respect of three distinct categories of crypto-assets: **e-money tokens**, **asset-referenced tokens** and **other crypto-assets**. Issuers of crypto-assets that meet the criteria under the applicable regime will be permitted to offer those crypto-assets to the public or admit them to trading anywhere in the EU. Conversely, anyone across the globe issuing crypto-assets that could be subscribed for in the EU may be subject to these requirements.



E-money tokens

The e-money token regime is intended to capture tokens that commercially function as electronic money, including those that may be structured in a way that means they are not caught under the existing Electronic Money Directive (EMD). The lawmaker has sought to include equivalent requirements in order to avoid regulatory arbitrage between the two regimes. The new regime also seeks to cater for token-specific risks as well as the possibility of systemically important issuances, which are not addressed under the EMD.

The key features of the regime are summarised in the table below.

E-money token	A type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender
Required form of issuer	Legal entity established in the EU
Authorisation	Issuer must be authorised as a credit institution or electronic money institution
Whitepaper	Whitepaper must meet all relevant mandatory disclosure requirements set out in MiCAR and be notified to the competent authority at least 20 working days before publication
Ongoing obligations	Issuer must comply with all ongoing requirements applicable to electronic money institutions
Claim on issuer/ redemption rights	Token holders must be provided with a direct claim on the issuer and the issuer must redeem at any time and at par value the monetary value of the tokens
Prohibition on interest	Issuers are prohibited from paying interest or any other benefit related to the length of time during which the token is held
Significant issuances	Additional prudential requirements apply to tokens that are deemed "significant" by the European Banking Authority (by reference to pre-defined criteria.

Asset-referenced tokens

The asset-referenced token regime broadly applies to tokens stabilised by currencies, commodities and/or crypto-assets, with the exception of a single currency. This regime is intended to be the most stringent of the three, given the potentially heightened risks posed by these types of instruments in relation to market integrity, financial stability and monetary policy.

The key features of the regime are summarised in the table below.

Asset-referenced tokens	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 a combination of such assets
Required form of issuer	Legal entity established in the EU
Authorisation	Issuer must be authorised as an asset-referenced token issuer under MiCAR or as a credit institution
Whitepaper	Whitepaper must meet all relevant mandatory disclosure requirements set out in MiCAR and be approved by home state authority in authorisation process
Ongoing obligations	Extensive ongoing obligations including around conduct, disclosure, complaints-handling, conflicts of interests, governance, own funds, management of reserve assets and orderly wind-down.
Claim on issuer/ redemption rights	No outright requirement for a direct claim or redemption right against the issuer or reserve. However, issuers that do not grant such rights are required to put in place mechanisms to ensure the liquidity of the tokens.
Prohibition on interest	Issuers are prohibited from paying interest or any other benefit related to the length of time during which the token is held
Significant issuances	Additional prudential requirements apply to tokens that are deemed "significant" by the European Banking Authority (by reference to pre-defined criteria).

Other crypto-assets

This regime is intended to be a catch-all, to cover all crypto-asset issuances that are not covered by other regimes. The approach provides for a degree of regulatory oversight and control without burdening authorities with having to approve every issuer or issuance in advance.

Other crypto-assets	Crypto-assets other than e-money tokens and asset-referenced tokens
Required form of issuer	Legal entity (established anywhere)
Authorisation	N/A
Whitepaper	Whitepaper must meet all relevant mandatory disclosure requirements set out in MiCA and be notified to the competent authority at least 20 working days before publication
Ongoing obligations	Limited ongoing obligations, including in relation to conduct, conflicts of interest and cyber-security
Claim on issuer/ redemption rights	N/A
Prohibition on interest	N/A
Significant issuances	N/A

Crypto-asset service providers

MiCAR requires anyone seeking to provide crypto-asset services in the EU (for example, in relation to custody, trading, exchange, brokerage, promotion or advice) to have been authorised in an EU Member State for the services it wishes to undertake. For this purpose, it needs to establish a registered office in that state. An authorisation provided by one EU member will be valid across the EU.

Authorised service providers must comply with a list of general requirements (e.g. conduct, prudential safeguard, operational requirements, complaints handling, management of conflict, outsourcing etc.) as well as additional specific requirements applicable to the particular services they provide (e.g. custody of crypto-assets, operation of a trading platform, exchange of crypto-assets (against fiat or crypto), execution of orders, advice, AML etc.)

Crypto-asset service providers will also need to be mindful that their authorisations may be withdrawn if they fail to comply with national implementations of EU legislation in respect of money laundering or terrorist financing.

Market abuse regime

MiCAR also seeks to establish market abuse rules for crypto-asset markets. Under the proposal, crypto-assets that are admitted to trading on a crypto-asset trading platform that is operated by a crypto-asset service provider would be subject to the new rules. The rules include requirements relating to the disclosure of inside information as well as prohibitions on insider dealing, unlawful disclosures of inside information and market manipulation.

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