Crypto Valley

Position sheet of the CVA on the European proposal for a Crypto-Asset Regulation (MiCAR)

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Introduction

The present paper aims to provide the reader with a few highlights from a Swiss perspective on selected key points of the proposal for a Regulation on Markets in Crypto-assets amending Directive 2019/1937, also known as "**MiCA**". As of 21st January 2021, this important piece of legislation is currently at the stage of its first reading at the Council of the European Union.

"A framework's scope full of unclarities"

First, many critics agree that MiCA might likely result in uncertainty regarding the future of the European regulatory framework on crypto-assets[1].

The proposal sets in MiCA art. 2 al.2 an **exclusion of certain titles from its scope** amongst which falls notably the notion of "financial instruments" as defined under art.4(l) point (15) 2014/65/EU[2]. In short, MiCA foresees that the general regulation - such as MiFID or Prospectus Directive - will still apply exclusively and is left virtually untouched by the proposal.

We believe this assertion is likely to be questionable since, most often, stablecoin's stability relies on the securitization of a right attached to the token to maintain its value. In this classic hypothesis, the title would 90% of the times be likely to qualify as a securities (i.e. a financial instrument) under current EU law. Hence, the actual scope of application of MiCA would consequently be relatively marginal. In any case, the line between which type of tokens falls under which regulation is blurred. In particular, we cannot assume that the sole use of blockchain technology is a criterion to apply MiCA, as MiCA's approach is to be technology-neutral.

Further, this proposal being a Regulation, its application will **replace all existing national frameworks** so far it is not covered within EU law. Thus it amputates most of the nascent regulatory environment, especially those from its most innovative Member States, contributing to the legal certainty surrounding blockchain's projects in the EU.

[1] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12089-Financial-services-EU-regulatory-framework-for-crypto-assets/F1439673

[2] See also Regeste n°6 MICA : "[financial instruments] remain regulated under the general existing Union legislation, including Directive 2014/65/EU, regardless of the technology used for their issuance or their transfer. "

"Numerous new definitions and specific stakeholders"

MiCA's proposal provides us with an impressive **set of definitions** (art.3 MiCA) that could potentially be modified at will in the future as stated in art.3,2 "to adjust those definitions to market developments and technological developments". We mention a few of them that raised our interest.

First, a rebranding of the name from "***stablecoins***" to "asset-referenced token", for no particular reasons. Some are determined as significant (art.39 MiCA[3]), while others are not (art.15 ff. MiCA[4]). Namely, we note this definition excludes notably the notion of algorithmic stablecoins (Regeste 27 MiCA). The term significant being related to three criteria: the size of the issuer's customer base, the size of the issuer's reserve of assets, and the value of tokens issued. Significant stablecoins are assessed, classified, and supervised by the European Banking Authority (EBA). Also this definition does not provide clarity whether it can be applied to second-layer networks such as the Lightning network where tokens in this network are asset-referenced to Bitcoin. If a token is backed by Bitcoin should we consider this token as a stablecoin?

Second, article 3 al.1 ch.6 MiCA defines the concept of ***issuer of crypto assets***, which includes individuals who seek the admission of crypto-assets in the Union (only active behaviour in our understanding). This intentionally broad definition will enable the Authorities to exclude, at EU-wide range, all platforms (broadly defined in art.3 al.1 ch.11 MiCA) from trading unwanted tokens - like presumably privacy coins to European citizens (see art. 57f Ordinance DLT[5]).

Third, the new set of definitions clearly distinguish ***e-money token*** (art.3 al.1 ch.4 MiCA, Regeste 10) regulated under MiCA from e-money regulated under Directive 2009/110. This definition is particularly redundant. We wonder why e-money token was not simply encompassed under the E-money directive, especially from a systematic perspective, and when a technologically neutral approach was branded. The report justifies this approach as it would enable a better assessment of systemic stablecoins, presumably better.

Fourth, we note the broad approach of the concept of "***crypto-asset service***" (art.3 al.1 ch.9 MiCA). Besides the usual activities that were expected (custody, trading, exchange, placing), this concept encompass also individuals providing personalised or specific advice on crypto-assets (art.3 al.1 ch.9 let.h MiCA; art.73 MiCA), which will thus require an authorisation.

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[3] Art. 39 : Significant asset-referenced tokens. The EBA shall classify an asset-referenced token as significant based on a) the size of the customer base of the promoters of the asset-referenced tokens, b) the value of the asset-referenced tokens or their market capitalisation, c) the number and value of transactions, d) the size of the reserve of assets, e) the significance of the issuers' cross-border activities and f) the interconnectedness with the financial system.

[4] Art. 15: Authorisation to offer asset-referenced tokens to the public and to seek their admission to trading on a trading platform for crypto-assets.

[5] https://www.admin.ch/gov/fr/accueil/documentation/communiques.msg-id-80775.html

Fifth, we mention the notion of "***management body***" (art.3 al.1 ch.18 MiCA), which is some kind of non-controlling entity setting strategy, objectives and the overall direction and which includes persons who direct the business of the Entity. This stakeholder falls notably under the liability regime of issuers (art. 14 MiCA). This is particularly interesting due to the "Foundation" model that was adopted in Switzerland early on.

"A few specific questions: Airdrops & token issued via mining"

The emission of new-minted token for maintenance or validation of transaction (mining) as well as the practice of giving away tokens for free (a.k.a Airdrop) were exempted under MiCA from several requirements in comparison with a usual ICO (art. 4 al.2 MiCA). However, they both still require that the individual conducting it to be registered as a legal entity in the EU (art. 4 al.2 MiCA), in our understanding only a legal person. The cross-border implications are unclear, as to how this situation will be assessed if, for example, a miner from China, mints token labelled EU.

"Specific regime for many stakeholders"

Crypto-asset services are explicitly and sometimes extensively regulated, specifically to the risks they pose (Regeste 59 MiCA). Without too many details here, we will give the following precisions. There are two categories to distinguish: 1) issuers of crypto-assets and 2) crypto-assets service providers that were defined above.

Regarding the issuance (issuer of crypto-asset), there are broadly three different situations, i.e. the issuance of: a) a simple crypto-asset b) an asset-referenced token (significant / non-significant) c) e-money token (significant / non-significant). However, MiCA does not take into consideration a fourth category – hybrid tokens – having the characteristics of payment/utility tokens or security/utility tokens.

MiCA proposal will regulate the offering of crypto-assets itself extensively. It will impact the prospectus requirements, content, notification to the authorities, publication, control and set civil liabilities. In the context of an offering, MiCA sets a de minimis threshold under 1 Mio Euro over 12 months. It is one of the possible exemptions. Further, we note a crypto-asset issuance under the form of an asset-referenced token is well regulated as it contains specific wind-down procedures, reserve asset details, and acquisition rules.

"The legal entity requirement"

One of the main topics of concern during our discussion was creating a legal entity in the EU. On the side of the ***issuer* of crypto-asset**, MiCA requires to be a legal entity (art.4 al.1 let.a MiCA). In this optic, when the issuer issues asset-referenced tokens or e-money tokens they must in addition have a registered office in the EU (Regeste 27 ; art. 43 al.1 let.a MiCA). Further, regarding **crypto-asset *services***, MiCA requires the creation of a legal entity that is registered in the EU (art. 53 MiCA).

"Impact of MiCA on third party country like Switzerland"

As a general rule of thumb, MiCA foresees that it applies to persons engaged in the issuance of crypto-assets or provide services related to crypto-assets in the European Union (art. 1 MiCA).

The first use case relates to persons established in the Union receiving crypto-asset services from a third-country firm at the **Client's own initiative** (Hypothesis Regeste 51 MiCA). In this constellation, it is not considered as provided in the Union as long as the firm does not solicit clients or potential clients in the EU or promotes, advertises crypto-asset services or activities in the Union.

The second use case relates to the use case **where a service is provided or an issuance of crypto-asset is foreseen in the EU**. Prior, a few possible exceptions exist where MiCA does not apply (art. 2 al.3 let.d), for instance, when a service is provided exclusively for parent companies, for subsidiaries or other subsidiaries of the parent companies.

However, in most cases, **MiCA will be applicable**. Hence, the first step will be to establish where lies the home Member State (art. 3 al.1 ch.22 MiCA) that is relevant for the crypto-asset service or the issuance.

In the first range of hypothesis, in case the firm offers a **crypto-asset services** (1), or **issue an asset-referenced token** (2), or **issue e-money token** (3), the home member state will be decided by the place where the project is registered (Crypto-asset services: art.3 al.1 ch.22 let.f MiCA; Issuer: art. 3 al.1 ch.22 let.d-e MiCA), as one has a legal obligation to settle a legal entity within the EU, or face quite heavy sanctions (art. 92 MiCA).

In the second range of hypothesis, where the issuer **issues a simple crypto-asset** (not asset-referenced token or e-money token), then the home member state will be the place of

its branch(es) (art. 3 al.1 ch.22 let.a-b MiCA). When the firm is only present in one country, then the home member state would be at the choice of the issuer, either the Member State where the crypto-assets will be offered to the public for the first time, or the Member State where the first application for admission to trading on a trading platform for crypto-assets is made (art. 3 al.1 ch.22 let.cMiCA).

In conclusion, we see here a clear choice from European legislators to create a regime forcing the establishment of a well-identified responsible legal entity within its borders and to increase the level of bureaucracy in application procedures and hence its cost. This regime could constitute an unjustifiable technical barrier to trade for new entrants, especially from developing countries, and a clear challenge to Defi's decentralized model, which might find it more attractive to move their activities elsewhere. In our view, the legislators contribute in creating legal fragmentation, and we can regret this extensive regulation did not foresee prior, as it is the norm in financial and data protection law, to create an equivalence regime (see through report proposal art. 122 al.2 let.k MiCA) and distort the supply of financial services.

"Risks in general"

Finally, some members of our committee highlighted the fact that MiCA heightened again a little more the regulatory cost of entrance and the burden of compliance. This aspect may prevent innovation from unregulated players and favour traditional financial institutions benefiting from previous authorisation and compliance (Regeste 54 MiCA), consequently hindering diversity, inclusion and creating an undue competitive advantage compared to new entrants. Further, they advocate, not without a glimpse of bitterness, that self-regulation would have been a viable option instead of a copy-paste subset of rules derived from the current financial system.

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