MICA – OVERVIEW OF THE NEW EU CRYPTO-ASSET REGULATORY FRAMEWORK (PART 2)

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This is Part 2 of a three-part series which examines the main elements of the new MiCA regime in the EU. As a recap, our discussion is based on the Compromise Text (published on 5 October), with references also made to the three previous versions of MiCA used, respectively, by the European Commission (Commission), the European Parliament (Parliament) and the EU Council (Council) in their negotiation. Please see Part 1 for further information, which can be accessed here.

This Part 2 examines the requirements applicable to stablecoins and non-stablecoins. The requirements appear to be based on, particularly for non-stablecoins, the existing disclosure regime under the EU Prospectus Regulation for offering or listing certain securities in the EU that requires the preparation and publication of a prospectus with specified content. The MiCA regimes for stablecoins and non-stablecoins also appear to borrow heavily from other existing EU regulatory regimes such as the authorisation requirements under the Electronic Money Directive.

STABLECOINS

MiCA puts what is commonly known as a stablecoin into two categories: "asset-referenced token" and "electronic money token" or "e-money token". Please see Part 1 for further detail of crypto-asset categorisation under MiCA and in the UK.

ASSET-REFERENCED TOKEN

Authorisation and Other Key Requirements

For any asset-referenced token to be offered to the public in the EU or to be admitted to trading on a crypto-asset exchange in the EU, the issuer of the asset-referenced token must be established in the EU and must obtain authorisation before doing so. Authorisation, once granted, is valid throughout the EU. This means that if an issuer gets authorised in one EU member state it can offer its token to the public, or seek the token's admission to a crypto-asset trading platform, in another EU member state, without having to obtain separate authorisation from that other EU member state.

Various requirements must be met in order obtain authorisation, including the specified capital requirement (which is the higher of EUR 350,000, 2% of the daily average amount of the reserve (i.e. assets used to back up the token's value) over the preceding 6 months and a quarter of the fixed overheads of the preceding year), having relevant internal procedures and governance arrangements in place, preparing a white paper (which must comply

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with specified content and form requirements), and obtaining a legal opinion (that confirms the token is within scope).

The Parliament also proposed in its negotiation version that a cryptoasset trading platform operator could apply for authorisation to admit a decentralised asset-referenced token[1] to trading on its platform. The Compromise Text, by contrast, omits all the provisions relating to decentralised crypto-assets proposed by the Parliament. Instead, the Compromise Text clarifies (in a recital) that decentralised crypto-assets are not within scope but it requires the Commission to assess the decentralised market within 18 months of MiCA taking effect for possible further legislation.

The home member state regulator[2] can withdraw authorisation in certain circumstances including where the token in question is considered to pose a "a serious threat" to financial stability, smooth operation of payment systems or market integrity, and where the European Central Bank (for the Euro Zone) or a central bank of a non-Euro Zone member state issues an opinion that the token poses a "serious threat" to monetary policy transmission, smooth operation of payment systems or monetary sovereignty. Further, the home member state regulator must also impose limits (on the amount to be issued or the minimum denomination) if the ECB or a relevant central bank issues an opinion that the token poses "a threat" to the monetary policy transmission, smooth operation of payment systems or monetary sovereignty. These requirements in the Compromise Text are essentially those proposed by the Council in its negotiation version.

There are also on-going requirements that must be complied with including those on the segregation and custody of the reserve assets (used for stabilisation purposes), disclosure and reporting requirements. Further, an asset-referenced token must not generate interest: the issuer cannot give interest, and crypto asset service providers dealing with it cannot either. The Compromise Text adopts the definition of "interest" proposed by the Council which appears broad - "interest" covers any remuneration or benefit related to the length of time a holder holds the token, including a discount, whether given by the issuer or through a third party, directly associated with the token or through the remuneration or pricing of other products.

Exemptions From Authorisation

The issuer of an asset-referenced token does not have to seek authorisation in either of the following two cases:

- The average daily outstanding value of all such tokens issued, calculated over 12 months, does not exceed EUR 5 million or equivalent in another currency, and the issuer is not linked to a network of issuers covered by this exemption.

For these calculation purposes, the Commission referred to "the average outstanding amount of asset-referenced tokens" (the wording was adopted by the Parliament without changes); it is not clear what geographical area this should cover so it could potentially capture all the tokens issued by an issuer worldwide. The Council proposed to narrow the calculation to "the average outstanding value of all asset-referenced tokens issued in the EU by an issuer". However, the Compromise Text has its own different wording - "the average outstanding value of all of asset-referenced tokens" [sic]. The fact that this wording does not include the Council-proposed "in the EU" seems to suggest that the calculation should cover all the tokens issued by a particular issuer throughout the world.

- The tokens are offered solely to "qualified investors" and can only be held by qualified investors.

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The Compromise Text defines "qualified investors" to mean per se professional clients only under MiFID II, which follows the Council's negotiation position. The Commission and Parliament in their respective versions defined "qualified investors" to cover both per se professional clients and elective professional clients under MiFID II.[3] However, neither the Compromise Text nor the three negotiation versions clarify what "can only be held by qualified investors" means. For example, does it mean there must be measures to prevent non-qualified investors from holding the tokens from a technological perspective?

Although such an issuer will not need authorisation, it must still produce a white paper (that meets the specified requirements) and effectively get it approved by the relevant regulator.

EU Credit Institution

If the issuer is an EU credit institution, it is not subject to the authorisation and authorisation-related requirements. The Commission and Parliament in their respective negotiation versions proposed that such credit institution issuers only need to get a white paper produced and approved. However, the Compromise Text adopts the Council's position, that is that EU credit institution issuers must still provide extensive information to their regulator (which is similar to that required for an authorisation application, including a legal opinion confirming the tokens are within scope).

Note that those excluded/exempted from the authorisation requirements must still comply with certain disclosure and reporting requirements.

Significant Asset-Referenced Token

If an asset-referenced token is considered to be "significant", an enhanced regime will be triggered, with additional and more stringent requirements becoming applicable such as remuneration requirements and liquidity management requirements. Further, the European Banking Authority (EBA) will become the lead regulator for any significant asset-referenced token (i.e. the issuer's home regulator will then take a cooperation role).

In summary, an asset-referenced token is significant if three of the following criteria are met:

1. The number of token holders is more than 10 million (The Commission initially proposed 2 million but the Compromise Text adopts this 10 million threshold proposed by the Parliament and Council);
2. The value, market capitalisation or the reserve is over EUR 5 billion (again the Compromise Text adopts this higher threshold proposed by the Parliament and Council, instead of the initial EUR 1 billion proposed by the Commission);
3. The daily number or value of transactions exceed, respectively, 2.5 million and EUR 500 million (again these are as proposed by Parliament and Council, while Commission initially proposed 500,000 and EUR100 million);
4. The issuer is considered significant on an international scale;
5. The token is considered to be interconnected with the financial system; and
6. The issuer issues at least one additional asset-referenced token, e-money token or provides at least one crypto-asset service.

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The criteria in points (4) to (6) are subject to further clarification under secondary legislation to be made by the Commission.

E-MONEY TOKEN

The issuer of an e-money token must be authorised as a credit institution, or as an electronic money institution (EMI) under the EU Electronic Money Directive (EMD), before offering it to the public in the EU or seeking its admission to trading in the EU. The issuer must also publish a white paper that complies with the specific content and form requirements, and must comply with the conduct of business requirements under the EMD (as modified by MiCA) such as the token holder's right to redeem, on request, their e-money tokens.

Note that an e-money token referencing an EU currency will be deemed to be offered to the public in the EU. This means that a third country (i.e. non-EU) issuer may nonetheless become subject to this authorisation requirement even if it does not actually offer its tokens to the public in the EU.

Small EMIs that meet certain size criteria do not require authorisation under the EMD (subject to local implementation of the EMD). They are not subject to the above authorisation requirement to offer e-money tokens in the EU or to seek the admission of such tokens to trading in the EU, but they must still prepare and publish a white paper that meets the relevant requirements and comply with the EMD conduct of business requirements (as modified by MiCA).

The Commission and Parliament in their respective versions provided the same exemptions for e-money tokens as for asset-referenced tokens (i.e. the EUR5 million outstanding issuance and the qualified investor exemptions discussed above). But the Compromise Text adopts the Council's position by simply applying the exclusions under the EMD to e-money tokens (e.g. an e-money token used for payment within a limited network is outside the scope of the above authorisation requirement).

The regime for significant e-money tokens is similar to that for significant asset-referenced tokens. One key difference is that the EBA will not take on the role of lead regulator if, with respect to the significant e-money token, at least 80% of the token holders and transaction volume are concentrated in the home state; i.e. the home regulator continues to lead the supervision.

NON-STABLECOINS

Crypto-assets that are neither asset-referenced tokens nor e-money tokens are subject to a lighter regime. Essentially, if the crypto-assets are offered to the public in the EU or are to be admitted to trading in the EU, the issuer of such non-stablecoin crypto-assets must obtain relevant regulator approval of a white paper meeting specified content and form requirements.

The Parliament proposed fairly extensive conditions on such an issuer including that the issuer must be based in the EU and the issuer must not have a parent or a subsidiary in a high-risk country from an AML perspective, a non-cooperative jurisdiction for tax purposes or a tax haven. The Compromise Text essentially follows the position of the Commission and Council and does not contain any of these conditions. The Parliament also proposed some provisions relating to decentralised tokens[1] in this regard but, as mentioned above, the Compromise Text pushes the possible regulation of decentralised tokens[1] into the future.

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Exclusions

Certain non-stablecoin crypto-assets are exempted from the white paper requirements. Effectively, these exemptions apply only to offering to the pubic in the EU, but not seeking admission to trading in the EU. The Commission and Parliament in their negotiation versions proposed to apply these exemptions to both, but the Compromise Text adopts the Council's position and limits these exemptions to offering to the public only. These exemptions are, in summary:

- The crypto-asset is offered for free (note that "free" is interpreted narrowly: if purchasers have to provide or undertake to provide personal data, or any fees, commissions or benefits are received by the offeror, then the offering is not free);
- The crypto-asset is automatically created as a reward during the validation process (i.e. mining);
- The crypto-asset is a utility token for goods/services that are already in existence or in operation;
- The token holder can only use it for goods and services in a limited network of merchants with contractual arrangements with the offeror (subject to certain notification requirements where the total consideration exceeds EUR1 million);
- The offer is to fewer than 150 persons per member state where such persons are acting on their own account;
- The total consideration, over 12 months from the beginning of the offer, does not exceed EUR1 million or its equivalent in another currency; and
- The offer is solely addressed to qualified investors and the crypto-asset can only be held by such qualified investors (see above for discussion on "qualified investors").

As noted above, this is Part 2 of a three-part series. In Part 3, we will take a close look at the requirements for the specified crypto-asset services which are subject to a MiFID-like regime.

FOOTNOTES

[1]The Parliament does not define nor explain what a "decentralised asset-referenced token" refers to. As commonly understood, a decentralised token is typically a token that is issued via a smart contract where there is no single entity/organisation that functions as an issuer.

[2] The regulator of the EU member state in which the issuer is established.

[3] A "per se professional client" is essentially any regulated firms (such as banks, investment firms etc) and certain large organisations (that meet specified size criteria); an "elective professional client" is effectively a retail client (e.g. an individual) that is upgraded to professional status upon meeting certain specified sophistication criteria.

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