

Crypto's Regulated Future in the EU & UK – What happens now?

22 March 2023



2023

Seminar Programme schedule

Crypto's Regulated Future in the EU & UK – What happens now?

Mia Dassas – Partner, ICM

Baptiste Aubry – Counsel, ICM

Nikki Johnstone – Partner, Financial Services Regulatory

Wednesday 22 March

9.00-10.00am

UK individual accountability in financial services: Themes, trends and challenges

Sarah Hitchins – Partner, Litigation & Investigations

Robbie Sinclair – Partner, Employment

Marc Teasdale – Managing Director, A&O Consulting

David McMenamin – Associate, Litigation & Investigations

Thursday 23 March

9.00-10.00am

Liability management – risk and opportunity in the world of leverage

Nick Charlwood – Partner, Banking

John Kicken – Partner, ICM US Corporate Finance Group

Joseph Badtke-Berkow – Associate, Banking

Tuesday 28 March

3.00-04.00pm

Recent developments in banking and finance law

Richard Hooley – Consultant, Banking

Friday 31 March

12.30-1.30pm

Embedding the Consumer Duty in the Payments & E-money Sector

Ben Regnard-Weinrabe – Partner, Financial Services Regulatory

Nikki Johnstone – Partner, Financial Services Regulatory

Sarah Hitchins – Partner, Litigation & Investigations

Tom Anderson – Executive Director, A&O Consulting

Wednesday 26 April

9.00am-10.00am

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Contents

Summary	4
Biographies	5
Crypto's Regulated Future in the EU & UK – What happens now?	7
Notes	32



Summary

Crypto's Regulated Future in the EU & UK – What happens now?

Both the EU and the UK have announced the introduction of new legal frameworks for the provision of cryptoasset activities. The EU's Markets in Crypto-assets Regulation (MiCA) in particular will come into force soon (from April 2023). The UK's proposed measures are aimed at mitigating specific risks posed by crypto firms, which shall be under consultation until 30th April 2023.

In this session, lawyers from our European and UK regulatory teams discuss the various ways that crypto firms can prepare for this new regulated environment, including:

1. understanding how your products, services or token offering(s) might be in-scope of these new regimes;
2. devising a licensing strategy for your key markets; and
3. anticipating future guidance from competent authorities.



Biographies



Mia Dassas

Partner – France
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Mia is specialised in financial services regulatory matters. She has extensive experience in advising French and foreign credit institutions and other financial institutions on the French financial regulatory aspects applicable to their deals in France as well as on the organisational and conduct of business rules applicable to their activities.

Furthermore, Mia advised on several major regulatory matters related to Brexit, including on greenfield licensing procedures for banks, broker-dealers, payment institutions and other financial institutions, as well as on third-country branch establishments and the provision of cross-border financial services. Mia also has a significant experience in advising French and foreign clients in M&A transactions in the financial services area, notably on the regulatory procedures and contacts with the regulators.

Mia regularly advises payment and electronic money institutions on the rules applicable to their activities, as well as on the review and negotiation of their contracts with their clients or counterparties.



Baptiste Aubry

Counsel – Luxembourg
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Baptiste advises on general banking, finance and ICM matters. He has a particular focus in regulatory matters (including CRD/CRR, MiFID, IFD/IFR, PSD, licencing requirements, governance issues and AML/KYC topics) involving financial institutions and asset managers, bank lending, structured finance and derivatives (including EMIR and MiFIR). Prior to joining Allen & Overy in 2015, he worked for six months in one of the major French banks and almost three years in a major Luxembourg law firm.

Baptiste joined the Luxembourg Banking Lawyers' Association (ALJB). He is a member of the MiFID Forum, the Compliance Forum, the Banking Supervision Forum, the Banking Union Task Force, the "Hierarchy of creditors", "Fair Consumer Protection Rules" and "Supervision of LCIs" working groups of the Luxembourg Bankers' Association (ABBL).

Baptiste is also an active member of our FinTech task force, supporting clients from established financial institutions, incumbents and start-ups in developing innovative products.



Biographies



Nikki Johnstone

Partner – London

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Nikki Johnstone is a partner in the Banking Regulatory & FinTech practice in the firm's London office.

Nikki is Fintech regulatory specialist who has extensive experience in advising financial institutions and technology companies on digitalisation, cross-border payments as well as cutting-edge innovations in cryptoassets and distributed ledger technology. She also provides specialist support to the firm's transactional teams on fundraising and M&A for established and growth Fintechs.



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Nikki Johnstone, Mia Dassas,
Baptiste Aubry
22 March 2023



Notes



2

Presenting today...

on how forthcoming regulation will affect crypto firms operating in Europe



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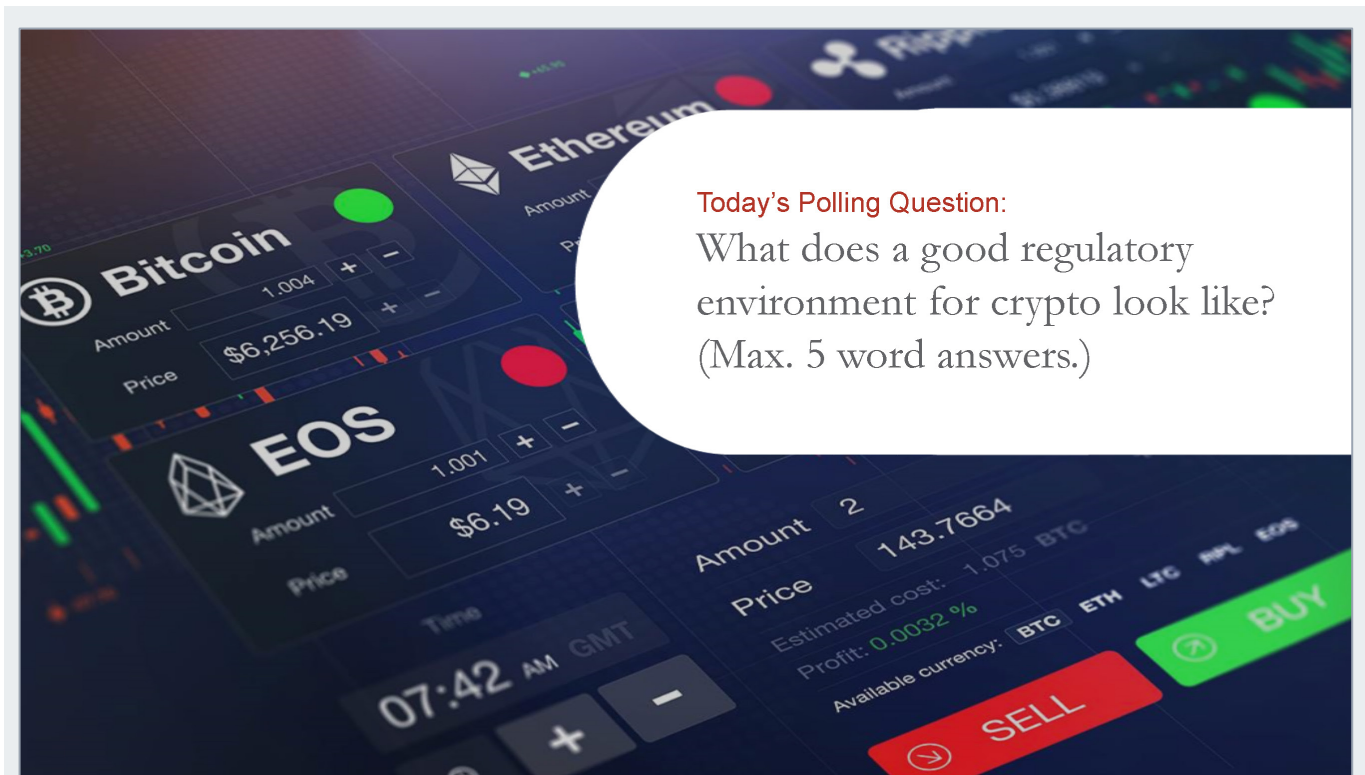
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3



Today's Polling Question:

What does a good regulatory environment for crypto look like?
(Max. 5 word answers.)

Notes



4

What we'll be talking about...

Agenda

- 01 Status update: EU and UK crypto regulatory frameworks.

- 02 As the EU and UK regulatory regimes come into being, how will crypto businesses be regulated?

- 03 Key considerations before applying for a crypto licence.

- 04 What will being a licensed "CASP" look like (and how can you prepare)?

- 05 Q&A Session

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5

Status update –
Where are we now?



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6

MiCA(R)'s journey through the legislative process



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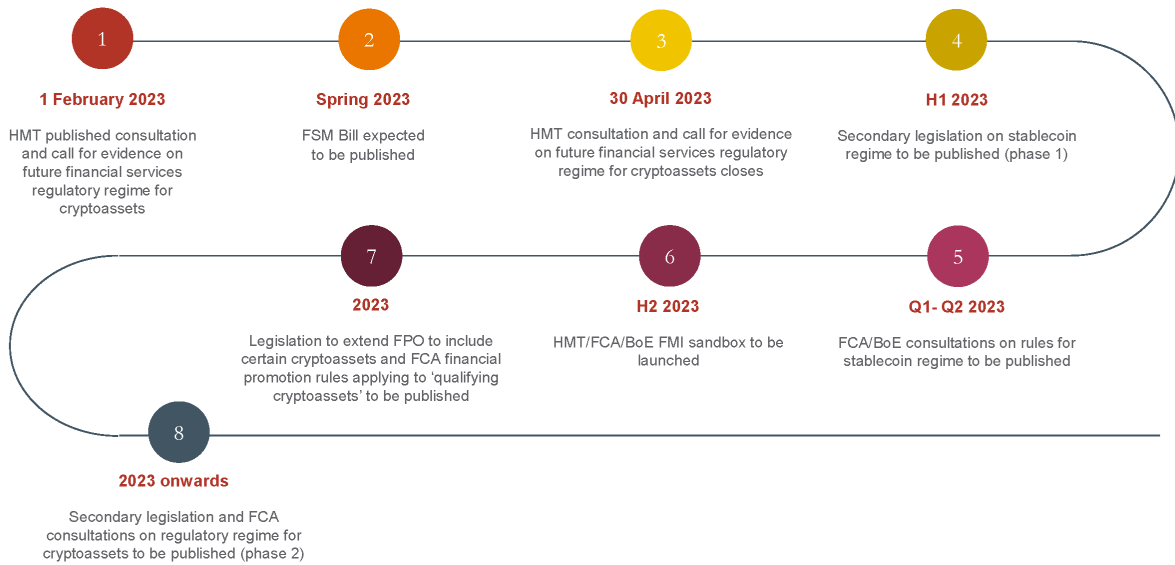
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7

In the UK, the future regulatory framework for crypto takes shape...



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8

The UK’s “Phased approach”

HMT intends to continue to pursue a phased approach to regulating cryptoassets, which is prioritised according to the areas of greatest risk and opportunity:

Phase 1

- Regulation of fiat-backed stablecoins which are used for payments
- Regime will address:
 - issuance activities relating to fiat-backed stablecoins
 - payment-related activities for fiat-backed stablecoins
 - custody activities relating to fiat-backed stablecoins

Phase 2

- For a broader range of cryptoassets, regulation of:
 - issuance activities
 - exchange activities
 - investment and risk management activities
 - lending, borrowing and leverage activities
 - safeguarding and/or custody activities
- Not all cryptoasset activities to form part of Phase 2

Future Phases

- Future phases include:
 - cryptoasset investment advice and portfolio management
 - post-trade activities in cryptoasset transactions (where not already covered in Phase 2)
 - crypto mining and transaction validation
 - operating a node
- DeFi
- Sustainability

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9

How will key crypto activities be regulated?



Notes



10

Issuing a “crypto-asset”

1

Crypto-asset:

“a digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology or similar technology”

Intentionally broad “catch-all” definition in line with FATF recommendations

“a digital representation of value, including a virtual currency, that can be digitally traded, or transferred, and can be used for payment or investment purposes”

Definition of “virtual asset” (AML Act 2004)

2

Three specific types of crypto-asset:

Asset-referenced token

“a type of crypto-asset that is not an electronic money token and that purports to maintain a stable value by referencing to any other value or right or combination thereof, including one or several official currencies”

E-money token

“a type of crypto-asset that purports to maintain a stable value by referencing to the value of one official currency”

Utility token

“a type of crypto-asset which is only intended to provide access to a good or service supplied by the issuer of that token”

Official currency

“an official currency of a country issued by a central bank or other monetary authority”

3

General obligations for token issuers:

Issuing a white paper, unless an exemption applies

Must include details of the issuer, the token project, rights and obligations of the holder, risks and environmental and climate-related impacts.

Cooling-off period

EU retail holders can withdraw from a primary market token purchase within 14 days provided that it has not been traded on exchange.

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11

EU: Stablecoins – issuance of EMT and ART (1)

Requirement	E-money Tokens	Asset-referenced Tokens
Status to be licensed as issuer	EU legal entity	EU legal entity
Authorisation	EU Credit Institutions or EU Electronic Money Institutions (EMIs) only	EU Credit Institutions or authorisation under MiCAR
Ongoing obligations	No additional obligations	Include conduct, disclosure, complaints-handling, conflicts of interests, governance, management of reserve assets
Regulatory capital / Own funds	No additional obligations	CET1 items and instruments – the higher of: <ul style="list-style-type: none"> • EUR 350,000, • 2% of reserve assets, • a quarter of the fixed overheads of the preceding year
Monitoring	N/A	ARTs of a value > EUR 100Mo = quarterly reporting of issuer to CA on main information on the ART (customer base, transaction volume, size of reserve, value)
Issuance restrictions	N/A	Estimated quarterly average > 1Mo transactions and EUR 200Mo (use as means of exchange) = stopping issuance and planning to limit transaction volume/value

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10

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12

EU: Stablecoins - issuance of EMT and ART (II)

Requirement	E-money Tokens	Asset-referenced Tokens
Reserve	<p>Segregation per normal rules for EMIs</p> <p>Funds received in exchange for e-money tokens may only be invested in <u>cash or secure, low-risk investments</u> denominated in the same currency as the one referenced by the e-money token</p>	<p>Reserve assets must be segregated and held with:</p> <ul style="list-style-type: none"> • a credit institution (all types of assets) or an investment firm (for financial instruments); and • a CASP for crypto-assets <p>Reserve assets can be invested, but only in low-risk, highly liquid financial instruments (losses resulting from the investments must be borne by the issuer)</p>
Claims on issuer / redemption right	Token holder must have direct claim on issuer to redeem at any moment, and at par value of the e-money tokens held + redemption planning	Grant right to redeem on issuer or reserve or mechanisms to ensure liquidity in tokens + redemption planning
Payment of interest on tokens	Prohibited	Prohibited
Change in control	Credit institutions/EMIs	Equivalent regime

Notes



13

EU: Stablecoins – Issuance of EMT and ART (III)

Requirement	E-money Tokens / Asset-referenced Tokens
Significant (voluntary classification possible)	<p>Offerings that meet <u>three</u> or more of the following thresholds may be classified by the EBA as "significant":</p> <ul style="list-style-type: none"> • Number of holders larger than 10 million; • Total value / Market capitalisation / Size of the reserve of issued tokens higher than EUR 5 billion; • Execution of more than 2.5 million transactions and value exceeding EUR 500 million per day; • The issuer is a provider of core platform services designated as gatekeeper in accordance with "Digital Markets Act"; • The significance of the activities of the issuer on an international scale (including use of tokens for payment remittances) • Interconnectedness with the financial system • The same person issues at least one more (EMT/ART) token and provides at least one crypto-asset service
Specific additional obligations	<p>Issuers of significant tokens have to:</p> <ul style="list-style-type: none"> • Implement internal remuneration policies that promote effective risk management, • Ensure that their stablecoins can be held in custody by different crypto-asset service providers on a fair, reasonable and non-discriminatory basis, • Establish liquidity management policies in relation to their product • Conduct, on a regular basis, stress testing (including on liquidity) that takes into account severe but plausible financial stress scenarios, • Comply with a own fund requirement threshold multiplied by a factor of 1.5
Supervision	<ul style="list-style-type: none"> • Direct supervision of the EBA (and creation of supervisory colleges)

Notes



14

UK: Only certain “fiat-backed [payment] stablecoins” for now...

Stablecoin issuance, custody and use as a means of payment

Government to develop a definition of “*payment cryptoasset*”, which will “*bring into scope any cryptographically secured digital representation of monetary value which is, among other things, stabilised by reference to one or more fiat currencies and/or is issued and used as a means of making payment transactions*”

Electronic Money Regulations (EMRs) and Payment Services Regulations 2017 (PSRs) will be amended to: (i) provide the FCA with appropriate powers over stablecoin issuers, wallet providers *et al*; and (ii) ensure convertibility into fiat currency, at par and on demand.

Activity	Sub-activities	What could the (amended) e-money regime require?
Issuance	Issuance and redemption of a fiat-backed stablecoin	<ul style="list-style-type: none"> • Becoming authorised as an EMI (or varying your existing licence permissions), unless an exclusion applies; • Regulatory capital and other prudential requirements; • Maintenance and management of reserve of assets; • Orderly failure and insolvency requirements; • Systems, controls, risk management and governance; • Notification and reporting; • Record keeping; • Conduct of business (and other consumer protection) rules; • Financial crime measures; • Outsourcing requirements; • Operational resilience, service reliability and continuity; and • Security requirements.

Notes



15

Non-fungible tokens: Out of scope (or are they...?)



EU MiCAR

Does not apply to "crypto-assets that are unique and not fungible with other crypto-assets"



- To be excluded, token needs to be **both** unique and non-fungible. Leaves open the possibility that tokens which are issued separately but are substitutable could fall within scope.
- Fractional parts of NFTs would fall within scope.



- If an NFT *is* in scope, is it a utility token?
 - A utility token "*is only intended to provide access to a good or a service supplied by the issuer of that token*" Article 3(1)(5)
 - What about a token which is linked with a separately hosted digital artwork – is this *access*?



UK Future Crypto Framework

NFTs initially presumed to fall outside regulation, but this is scope remains unclear.



- Govt confirmed that NFTs would not fall within scope of the financial promotion regime but this is on the assumption that they are unique and non-substitutable.
- A more nuanced approach is being taken wrt NFT-related activities:
 - For these purposes, NFTs defined as "cryptoassets which confer digital ownership rights of a unique asset (e.g. a piece of digital art), using a technology such as DLT to support the recording or storage of data", but which do not:
 - provide the rights or features associated with a security token; and
 - do not function as a means of payment.
 - NFTs may nonetheless fall within scope of regulation if their structure or characteristics result in them being treated as a "specified investment" in relation to a regulated activity...

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16

What other crypto services/activities will be regulated?

Specified services under MiCA	Service	Indicative relevant activities	UK Phase
Operating a trading platform for cryptoassets. Exchanging cryptoassets against fiat currency or other cryptoassets	Exchange platform	Operating a cryptoasset trading venue which supports: <ul style="list-style-type: none"> - The exchange of cryptoassets for other cryptoassets - The exchange of cryptoassets for fiat currency - The exchange of cryptoassets for other assets (e.g., commodities) 	Phase 2
		Post-trade activities in cryptoassets (to the extent not already covered)	Future phases
Executing orders for cryptoassets on behalf of third parties	Investment and risk management	Dealing in cryptoassets as principal or agent	Phase 2
Placing cryptoassets		Arranging (bringing about) deals in cryptoasset	
Reception and transmission of orders on behalf of third parties		Making arrangements with a view to transactions in cryptoassets	Future phases (or excluded)
Advising on cryptoassets		Advising (to the extent not already covered) on cryptoassets	
Portfolio management	Managing (to the extent not already covered) cryptoassets		
	Lending, borrowing and leverage	Operating a cryptoasset lending platform	Phase 2
Custody and administration on behalf of third parties	Custody	Safeguarding/safeguarding and administering a fiatbacked stablecoin and/or means of access to the fiatbacked stablecoin (or arranging same)	Phase 1
		Safeguarding or safeguarding and administering a cryptoasset other than a fiat-backed stablecoin and/or means of access to the cryptoasset	Phase 2
	Validation and governance	Mining or validating transactions, or operating a node on a blockchain	Future phases
		Using cryptoassets to run a validator node infrastructure on a proof-of-stake (PoS) network (layer 1 staking)	

Notes



17

Territorial scope

Current starting point, subject to exceptions and nuances (re specific activities):

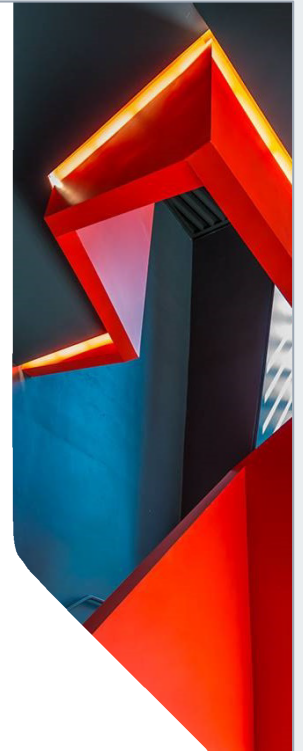
Location of crypto firm	Location of the customer		
	EU	UK	Overseas
EU	In Scope	In Scope	In Scope
UK	In Scope	In Scope	In Scope
Overseas	In Scope	In Scope	Out of Scope

For overseas firms, territorial scope is likely to vary by activity (and by country):

Key points to consider

- What might amount to doing business "in-country"?
- Is there an available exemption/exclusion for regulation, e.g. might reverse solicitation be available for provision of crypto-asset services?
- If a licence requirement applies, does a "location requirement" also apply, e.g. mandating an EU presence and local directors?
- Third country equivalence arrangements being considered in the UK **only**.

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18

Key considerations before applying for a crypto licence



Notes



19

Taking stock | Current crypto laws

VASP regime (driven by 5MLD)

Local "registration" requirement imposed on firms providing exchange and custody services in an EU country or in the UK

Supervisory warnings

Local regulators will often publish supervisory "warning notices" regarding certain types of token or, more often, a specific crypto firm.



Local crypto regimes

Whilst some countries have to date only applied existing laws or regulations to some aspects of crypto, others have established comprehensive legal frameworks for crypto, e.g. France, Germany, Malta.

Crypto product-specific bans

Some countries have banned the sale of specific crypto products, even when done by regulated firms, e.g. the UK FCA's ban on crypto-linked derivatives.

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20

Local regimes | French crypto-asset service providers regime

Definition of a cryptoasset:

"a digital representation of value that is not issued or guaranteed by a central bank or a public authority, which is not necessarily attached to a legally established currency and does not possess the legal status of a currency, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored or traded electronically"



Two types of licensing regime depending on the services to be provided



One new regime by 1 July 2023



Provision of crypto-asset services by providers based in or outside the EEA



Client categorisation



AML rules

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19

Notes



21

New firms | Planning for crypto licensing

Whilst minimum licensing requirements may be equivalent, other factors may be equally (or more) important



- 1 What resources are required on the ground, i.e. over and above minimum applicable "location requirements"?
- 2 What is the regulatory/supervisory environment for existing crypto firms?
- 3 Do the country's laws "gold-plate" international or regional expectations, in particular wrt AML?
- 4 Is it possible to find the right balance of talent in-country, i.e. board / management, financial crime compliance, risk, operations, security?
- 5 Buy vs Build – Is there a CASP (or other regulated entity) available for sale in-country? Would buying be a "better" option than a licensing process?


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22

If you already have a licence | Planning for crypto regulation

- 
- 1 Ensure that your proposed crypto products/services have been robustly tested against applicable legislation (which may overlap with other laws/regulations)?
 - 2 Consider whether your crypto offering may necessitate (or make desirable) a separate MiCA licence, including in another country?
 - 3 Prepare a strategy for engagement with your home state regulator, with a view to giving notice of your crypto activity (and perhaps varying your licence).
 - 4 If you provide services to CASPs, consider enhancing your due diligence process to reflect MiCA requirements (including gaining an understanding of how the CASP customer categorises tokens)?
 - 5 Ensure that your governance, risk management and other compliance policies are updated to reflect the crypto services you provide. If you issue ARTs or EMTs, engage with internal teams to develop a discrete recovery and redemption plan.

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23

How to prepare for crypto licensing



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24

MiCA – A “mini-MiFID” for CASPs



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25

Any Questions?

Q&A

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