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The MiCA Proposal at a glance

The key takeaway of a ground-breaking law to regulate the crypto-assets space

The MiCA Proposal – the pioneering mission

The **crash of TerraUSD**, the world's third-largest stablecoin, as well as the recent bankruptcy of **the leading crypto exchange FTX**^{*} and of its 130 affiliated companies have served as reminders that finance cannot be unregulated and stable at the same time.

To prevent and avoid serious detriment to the financial and market stability and to prevent retail investors from blindly investing in the crypto space, a clear regulatory landscape is required.

The need to ensure an adequate protection to investors while preserving the market integrity and the stability of the financial system is at the heart of the rationale for the European **proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets (the MiCA Proposal)**.

It is envisaged that *“the lack of an overall Union framework for crypto asset can lead to a lack of users’ confidence in those assets, which could significantly hinder the development of a market in those assets and can lead to missed opportunities in terms of innovative digital services, alternative payment instruments or new funding sources for Union companies”*.

At the time of writing this note, the publication of the final text of the MiCA Proposal in the Official Journal of the European Union is still pending (see below); however, it is foreseen that its adoption and implementation will mark the starting point of the first harmonised approach for the regulation of crypto-assets. The greater degree of legal certainty as well as the introduction of clear rules and protections for investors introduced by such dedicated and harmonised framework are also intended to reduce regulatory gaps or grey areas, thus attracting more institutional investment and growth.

The aim is to *“maintain competitiveness of the Member States on international financial and technological markets and provide clients with significant benefits in terms of access to cheaper, faster and safer financial services and asset management”*.

Please find summarised below the highlights which we believe are worth considering in relation to the MiCA Proposal. A follow-up will address the changes, if any, in the final text, once it is approved.

This note is not and is not intended to be an exhaustive and definitive review of the MiCA Proposal and is based on the text of the MiCA Proposal as lastly published by the European Council on 5 October 2022. Allen & Overy LLP is not in a position to foresee when the final text of the MiCA Proposal will be published in the EU Official Journal and whether this final version will differ, and to what extent, from the text of the MiCA Proposal.

^{*}Source: ESMA, Opening Statement, 30 November 2022, available at: https://www.esma.europa.eu/sites/default/files/library/public_statement_to_econ_sk.pdf

Executive Summary

1. The carve-outs

The MiCA Proposal does not apply to:

- **financial instruments** (as defined pursuant to MIFID II) which are governed by the current European legislation, including the recent Pilot Regime for financial instruments issued in DLT form;
- non-fungible crypto-assets, including **NFTs**; and
- Crypto-assets services (as defined by the MiCA Proposal) *provided in a fully decentralised manner without any intermediary, ie DeFI not in scope.*

2. Taxonomy

Crypto-assets will be classified as:

- *Electronic money tokens (EMTs);*
- *Asset-referenced tokens (ARTs); and*
- *Crypto-assets, other than asset-referenced tokens and e-money tokens.*

3. Who is this relevant to?

The MiCA Proposal applies to: (i) any legal person engaging in issuing, offering or requesting an admission to trading of crypto assets (**Crypto-Issuers**); and (ii) the provision of services related to crypto assets (**the crypto-assets service providers** or **CASPs**).

– Crypto-Issuers

- The general applicable regime includes the publication of a **white paper** and its notification to the relevant National Competent Authority (**NCA**). Additional requirements pertain *inter alia* to marketing communications, rules of conduct and the liability regime.
- ARTs and EMTs** are also subject to certain restrictions (including *inter alia* the stoppage in the issuance of asset-referenced tokens and, to a certain extent, EMTs when the estimated quarterly average number and value of transactions per day to uses as means of exchange is higher than one million transactions and EUR200 million respectively, within a single currency area). Crypto-issuers must have and custody reserve of assets and grant holders redemption rights at all time in the ARTs.

In addition **EMTs** shall be deemed “electronic money”. Holders of EMTs also have a claim on the issuer and the EMTs shall be issued at par and on the receipt of funds. Upon request by any holder of EMTs, the issuer must redeem at any moment, and at par value, the monetary value of the EMT in funds other than e-money.

– CASPs

The relevant services provided by CASPs include: (A) the custody and administration of crypto-assets on behalf of third parties; (B) the operation of a trading platform for crypto-assets; (C) the exchange of crypto-assets for funds; (D) the exchange of crypto-assets for other crypto-assets; (E) the execution of orders for crypto-assets on behalf of third parties; (F) the placing of crypto-assets; (G) the provision of transfer services for crypto-assets on behalf of third parties; (H) reception and transmission of orders for crypto-assets on behalf of third parties; (I) providing advice on crypto-assets; and (J) providing portfolio management on crypto-assets.

CASPs are subject to certain rules of conduct, disclosure, governance and organisational requirements. A European passporting regime is provided.

CASPs are required to have their “place of effective management” in the EU and at least one of the directors must reside in the EU.

4. Market abuse

The MiCA Proposal sets out bespoke rules on market abuse committed in relation to crypto-assets being admitted to trading on a trading platform operated by a crypto-asset service provider or for which a request for admission to trading on such a trading platform has been made. These rules include disclosure of inside information, insider dealing and market manipulation.



The MiCA Proposal at a glance

The carve-outs

The MiCA Proposal is intended to apply to any legal persons engaging in the issuance, offer to the public and admission to trading of crypto-assets and/or in the performance of services related to crypto-assets in the Union which are not currently regulated by other pieces of European financial legislation.

Therefore, crypto-assets that qualify as “financial instruments” for the purpose of MiFID II, as recently amended, are explicitly carved out from the scope of the MiCA Proposal. In other words, crypto-assets that fall under existing European financial service legislation would remain regulated under the existing regulatory framework, consisting of the requirements laid down by pieces of legislation such as **MiFID II**, **MiFIR**, **EMIR**, **MAR** and **CSDR**, regardless of the technology used for their issuance or their transfer.

Where issued or negotiated on a blockchain basis, assets classifiable as “financial instruments” would be requalified as falling within the newly introduced category of “tokenised financial instruments” and, as of March 2023, may benefit from the Pilot Regime envisaged by **Regulation 858**.

The MiCA Proposal would not apply to crypto-assets that are unique and not fungible with other crypto-assets, including art and collectibles, whose value is attributable to each crypto-asset’s unique characteristics and the utility it gives to the token holder (the so-called NFTs). However, a substance over the form criterion should apply. This means that fungible NFTs should be considered as being covered by the MiCA Proposal irrespective of the designation assigned to them by the issuer or the crypto-asset service provider.

Crypto-assets services would not be covered by the MiCA Proposal where “*provided in a fully decentralised manner without any intermediary*”. Thus, if enacted as currently drafted, the MiCA Proposal would not apply to the so-called Decentralised Finance.

The first harmonised crypto-assets taxonomy

Under the MiCA Proposal, the crypto-assets will be classified, depending on whether they seek to stabilise their value by reference to other assets and the risk they entail, into one of the following:

- (a) *“Electronic money tokens” or “e-money tokens”*
(EMTs): crypto-assets stabilised by referencing one official currency;
- (b) *“Asset-referenced tokens” (ARTs)*: crypto-assets stabilised by reference to any other value or right (or combination thereof), including one or more official currencies; and
- (c) *“Crypto-assets, other than asset-referenced tokens and e-money tokens”*: crypto-assets that cannot be defined and treated as EMTs or ARTs and thus subject to a lighter-touch regulatory regime.

The MiCA Proposal – who is this relevant to?

The MiCA Proposal would apply to any persons who engage in:

- (a) the issuance, offering and admission to trading of crypto-assets (the **Crypto-Issuers**); or
- (b) the provision of services related to crypto-assets (the **crypto-assets service providers** or **CASPs**).

– Crypto-Issuers

- (i) According to the general regime and publication of the **white paper**:
 - the Crypto-Issuer must be a legal entity;
 - there is an obligation to draft, publish and notify to the relevant NCA a “crypto assets white paper”, namely an information document setting forth mandatory disclosures; and
 - additional requirements as to marketing communications, rules of conduct and the liability regime imposed on Crypto-Issuers for the information set forth in the crypto asset white paper shall apply.
- (ii) The regime applicable to ARTs and EMTs

In addition to the general regime set forth under (i) above, Crypto-Issuers of ARTs and EMTs shall, as the case may be, *inter alia*:

- notify the relevant NCA of certain information (including, *inter alia*, their business model, a legal opinion that ARTs do not qualify as EMTs, a description of governance arrangements, their business continuity policy, their internal control and risk management systems and their security system);
- as to ARTs only, have the white paper approved by the relevant NCA;

- be subject to certain monitoring requirements (including, *inter alia*, reporting their customer base, value of the asset reference token issued and reserve of assets, number of transactions per day etc. to the competent NCA);
- be subject to certain restrictions (including, *inter alia*, the stoppage of the issuance of the asset-referenced token and, to a certain extent, EMTs when the estimated quarterly average number and value of transactions per day to uses as means of exchange is higher than one million transactions and EUR200 million respectively, within a single currency area);
- identify, prevent, manage and disclose conflicts of interest;
- in terms of Crypto-Issuers of ARTs or EMTs to a very limited extent only, be subject to own funds requirements;
- have and custody reserve of assets (insulated and operationally segregated from the issuer’s estate and from the reserve of assets of other tokens); such assets shall be managed so as to address the liquidity risks associated to the permanent redemption rights of the holders and they shall invest such assets pursuant to certain specific criteria:
 - grant holders redemption rights at all times in the ARTs and EMTs; and
 - be prohibited from granting interest in relation to ARTs and EMTs.

As regards in particular EMTs:

- EMTs shall be deemed “electronic money” as defined by Directive 2009/110/EC, and an EMT which refers to a Union currency shall be deemed to be offered to the public in the Union;
- the Crypto-Issuer of EMTs shall qualify as a credit institution or e-money institution; and

- holders of EMTs have a claim on the issuer and the EMTs shall be issued at par and on the receipt of funds.

– CASPs

The following regime applies to CASPs:

- relevant services provided by CASPs include: (A) the custody and administration of crypto-assets on behalf of third parties; (B) the operation of a trading platform for crypto-assets; (C) the exchange of crypto-assets for funds; (D) the exchange of crypto-assets for other crypto-assets; (E) the execution of orders for crypto-assets on behalf of third parties; (F) the placing of crypto-assets; (G) the provision of transfer services for crypto-assets on behalf of third parties; (H) reception and transmission of orders for crypto-assets on behalf of third parties; (I) providing advice on crypto-assets; and (J) providing portfolio management on crypto-assets;
- CASPs are required to have their “place of effective management” in the EU and at least one of the directors must reside in the EU;
- a European passporting regime is provided;
- rules of conduct, disclosure, governance and organisational requirements shall apply as well as a regime and specific safeguard with which CASPs should be compliant when holding crypto-assets belonging to clients or other means to access such crypto-assets. CASPs would also be required to have in place prudential safeguards set as a fixed amount or in proportion to the fixed overheads of the previous year;
- CASPs providing a trading platform should have clear and transparent operating rules; and
- other requirements apply to the execution of orders on behalf of clients, the placing, reception and transmission of orders, advice and portfolio management of crypto assets.

The Market abuse regime

The MiCA Proposal sets out bespoke rules on market abuse committed in relation to crypto-assets being admitted to trading on a trading platform operated by a crypto-asset service provider or for which a request for admission to trading on such a trading platform has been made.

These include:

- the disclosure of inside information;
- insider dealing; and
- market manipulation.

Competent Authorities: the EBA and ESMA

While the general supervision over the crypto market operators would be granted to NCAs, the MiCA Proposal envisages a dual supervision by both NCAs and the EBA or the ESMA, as the case may be, which would apply in relation to significant issuers or significant issuances of crypto-assets.

The expected implementation of the MiCA Proposal

As of the date of this publication, it is still uncertain when the MiCA Proposal will be formally adopted by the European Parliament and published in the European Official Journal.

However, a transitional and grandfathering regime is envisaged as phasing in the enforceability of the provisions and requirements laid down by said ground-breaking regulation. In particular, the final version of the regulation on crypto-assets will apply from 18 months after its entry into force, although certain rules for ARTs and EMTs will start to apply after 12 months. This means that, based on the current expected timetable of EU law makers, the MiCA Proposal may enter into force in 2023, but in any event would not be enforceable until 2024.

How A&O can help

Once published, the MiCA Proposal would lay down the first landmark regime governing the crypto assets space in a comprehensive and harmonised manner; thus, its breadth would affect the crypto market globally and could represent a blueprint for other jurisdictions to follow.

Therefore, now is a good time to prepare for the main disruptive changes the MiCA Proposal is on the point of introducing and A&O would be happy to assist you in this process.

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