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European Commission Introduces Draft Regulation for Markets in Crypto Assets (MiCA)

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As part of its digital finance package,[1] the European Commission published a draft of a Regulation for Markets in Crypto Assets ("MiCA"). MiCA is intended to provide a comprehensive and harmonized regulatory framework for crypto assets that do not constitute financial instruments. Crypto assets to be covered by MiCA include, in particular, stablecoins, e-money tokens and utility tokens.

MiCA aims at regulating (i) the public offering of crypto assets, (ii) the admission of crypto assets to trading on a trading platform, (iii) the licensing of crypto asset service providers and (iv) the implementation of market abuse rules for crypto assets businesses. As an EU regulation, MiCA will apply directly in all EU Member States and will not require implementation by national laws.

Scope of MiCA

Three Types of Tokens

In general, MiCA will apply to the following three types of tokens:

- **Asset-Referenced Tokens**
  An asset-referenced token is a 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. This will include the Libra coin that was originally proposed by the Libra Foundation and was intended to be backed by a basket of currencies. Algorithmic

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[1] The digital finance package was adopted by the European Commission in September 2020 and includes (i) a communication of the European Commission on a digital finance strategy for the European Union, (ii) MiCA, (iii) a legislative proposal for a regulation on a pilot regime for market infrastructures based on distributed ledger technology and (iv) a legislative proposal for an EU regulatory framework on digital operational resilience. The digital finance package aims at building a competitive EU financial sector that gives consumers access to innovative financial products, while ensuring consumer protection and financial stability.

stablecoins will not constitute asset-referenced tokens, but they will fall within the catch-all category of other crypto assets.

- **E-Money Tokens**
  An e-money token is a 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. This will include USDC (a stablecoin issued by Circle and backed by U.S. dollars) and each single currency pegged Libra coin as proposed in Libra's whitepaper 2.0.

- **Other Crypto Assets (Catch-All Category)**
  This catch-all category covers all crypto assets other than asset-referenced tokens and e-money tokens. MiCA defines "crypto assets" as digital representations of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology. This category of tokens would in particular cover utility tokens but also Bitcoin and other similar tokens.

No Financial Instruments

MiCA will not apply if a crypto asset constitutes:

- a financial instrument,[2] such as a security token;
- e-money[3] (other than an e-money token);
- deposits;[4]
- structured deposits;[5] or
- securitization.[6]

If a crypto asset constitutes one of the above instruments, it will remain subject to the financial markets regulations applicable to such instruments. When submitting a whitepaper to the supervisory authorities, the issuers will be required to also submit an assessment or a legal opinion as to whether the tokens described in the whitepaper constitute a financial instrument or any other of the above-mentioned instruments.

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[2] As defined in in Article 4(1), point (15), of the Markets in Financial Instruments Directive (2014/65/EU) ("MiFID" II).

[3] As defined in Article 2, point (2) of the Directive 2009/110/EC ("E-Money Directive").

[4] As defined in Article 2(1), point (3), of Directive 2014/49/EU ("Deposit Guarantee Schemes Directive").

[5] As defined in Article 4(1), point (43), of MiFID II.

[6] As defined in Article 2, point (1), of Regulation (EU) 2017/2402 ("Securitization Regulation").

Issuer Licensing and Operating Conditions

Depending on the type of token, MiCA provides for different requirements for the licensing and operation of issuers of such token.

Issuers of Asset-Referenced Tokens

The licensing requirements for issuers of asset-referenced tokens include the following:

- the issuer must be a legal entity established in the European Union;

- it must evidence own funds in the amount of the greater of EUR 350,000 or 2% of the average of reserve assets (or other amount required by the relevant regulator); and

- it must comply with additional governance and business conduct requirements.

Credit institutions authorized under the Capital Requirements Directive ("CRD") may issue asset-referenced tokens under the existing credit institution license and do not need to obtain the MiCA license in addition.

Issuers of asset-referenced tokens also need to comply with certain ongoing obligations relating to the maintenance and custody of reserve assets. The reserve must be maintained at all times, and the number of tokens and the reserves must match, i.e., each creation or destruction of tokens must be reflected by a corresponding increase or decrease of reserves. The reserve assets must be segregated from the issuer's own assets and must be kept in custody with a crypto asset service provider, if crypto assets, or with a credit institution, if other assets.

MiCA will exempt from licensing requirements the issuers of small-scale offerings (up to EUR 5 million within 12 months) and the issuers of offerings to qualified investors (as defined in the Prospectus Regulation). In the latter case, the terms of an offering need to ensure that only qualified investors can hold the asset-referenced tokens (i.e., they are not on-sold to non-institutional customers).

Issuers of E-money Tokens

An issuer of e-money tokens must be a legal entity established in the European Union and licensed as a credit institution under the CRD or as an electronic money institution under the E-Money Directive. Also, the issuer of e-money tokens must comply with the operational requirements of the E-Money Directive. In addition, MiCA requires the submission and publication of a whitepaper and sets out the requirements on content and approval of such whitepaper.

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No license under the CRD or the E-Money Directive will be required for the issuers of small-scale offerings (up to EUR 5 million within 12 months) or offerings to qualified investors.

MiCA will further require that the e-money token must constitute a direct claim of token holders against the issuer, and the issuer must redeem the e-money token at any time at par value. MiCA states that such redemption must be carried out "in cash or credit transfer", but it is not clear whether it must be redeemed only in fiat currency or may also be redeemed in crypto assets.

Issuers of Other Crypto Assets

MiCA will not provide for any licensing obligation for issuers of other crypto assets such as utility tokens. An issuer of such a token must be a legal entity but may be established outside of the European Union. But such issuer needs to comply with certain governance and business conduct requirements.

Whitepaper

Content of Whitepapers

Irrespective of the type of token, the whitepaper must comply with minimum disclosure requirements similar to the disclosure requirements applicable to a prospectus, including the description of the issuer, the offered tokens and rights and risks associated with them. Such a whitepaper is therefore often also referred to as a "small prospectus".

In addition to the minimum disclosure requirements, MiCA requires the disclosure of specific information depending on the type of token. For an asset-based token, for instance, the whitepaper must provide a detailed description of the reserve assets and the custody arrangements. In the case of an e-money token, the whitepaper must describe the redemption rights of the token holders and the conditions for exercising such rights.

Approval of Whitepapers

The requirements on the approval of a whitepaper will vary depending on the type of token:

- A whitepaper relating to asset-referenced tokens must be approved by the relevant national competent authority ("NCA") prior to publication. Such

approval is part of the licensing process for the issuer of the asset-referenced token.

- A whitepaper relating to e-money tokens or other crypto assets will not need to be pre-approved by the relevant NCA. Such whitepaper must be submitted to the NCA at least 20 working days prior to publication. The NCA may suspend or prohibit the issuance of the tokens if it comes to the conclusion that the requirements under MiCA are not satisfied.

Exemption from Obligation to Publish a Whitepaper

The issuers of other crypto assets, i.e., other than asset-referenced tokens and e-money tokens, will not be required to submit and publish a whitepaper if the offering relates to:

- crypto assets issued for free;

- crypto assets created through mining as payment of gas fee/price;

- unique and non-fungible crypto assets;

- small-scale offerings, i.e., up to 150 persons per Member State or up to a total amount of EUR 1 million within 12 months; or

- offerings to qualified investors only.

Issuers of asset-referenced tokens and e-money tokens must submit and publish a whitepaper even if they are exempt from the licensing requirements for small-scale offerings or offerings to qualified investors.

Liability of Issuers for Content of Whitepapers

MiCA will provide for liability of an issuer for the content of the whitepaper similar to the prospectus liability of the issuer of financial instruments. In particular, the issuer of a whitepaper, or its management body, may be liable to the token holders for damages if the information provided in the whitepaper is not complete, fair or clear or is misleading. Any contractual exclusion of civil liability will not be respected at all. In addition, MiCA will provide that a Member State may impose any further civil liability under its national law.

"Significant" Asset-Referenced Token and E-Money Token

MiCA will introduce a category of "significant" asset-referenced token and "significant" e-money token. The European Commission realized that such significant tokens could raise certain challenges in terms of financial stability, monetary policy or monetary

sovereignty and therefore should be subject to more stringent requirements and enhanced supervision.

Criteria for "Significance"

The determination as to whether a particular asset-referenced token or e-money token constitutes a "significant" token will be made by the European Banking Authority ("EBA"). In order to make such determination, the EBA must consider the following criteria:

- size of customer base (not less than 2 million customers);
- value or market capitalization (not less than EUR 1 billion);
- number or value of transactions (not less than 500,000 transactions or transactions with a value of EUR 100 million per day);
- size of reserve assets (not less than EUR 1 billion);
- significance of cross-border activities (not less than seven Member States involved); or
- interconnection with the financial system.

The European Commission will be authorized to adopt delegated legislation further specifying the criteria for significance and to modify the threshold, subject to the above minimum thresholds.

Consequences of "Significance"

The issuer of an asset-referenced token or e-money token that has been determined to be significant by the EBA will be subject to higher capital requirements (up to 3% of reserve assets instead of 2%) and to certain interoperability requirements and will be required to establish a liquidity management policy.

The issuers of significant asset-referenced tokens will be subject to supervision by the EBA and not by the NCA.

The issuers of significant e-money tokens will be subject to dual supervision by both the EBA and the NCA. While the NCA will remain in charge of supervision of compliance with the requirements generally applicable to issuers of e-money tokens, the EBA will supervise compliance with the specific additional requirements applicable to issuers of significant e-money tokens, such as remuneration policy, liquidity monitoring, interoperability requirements, safe custody and investment rules and rules on orderly wind-down.

Regulation of Crypto Asset Service Providers

MiCA will also regulate the licensing and operating requirements for providers of crypto asset services. The requirements more or less resemble the requirements for investment firms under MiFID II.

Regulated Services

The crypto asset services regulated by MiCA are mostly similar to financial services that are subject to the financial services regulations and will include:

- custody and administration of crypto assets on behalf of third parties;

- operation of a trading platform for crypto assets;

- exchange of crypto assets for fiat currency that is legal tender;

- exchange of crypto assets for other crypto assets;

- execution of orders for crypto assets on behalf of third parties;

- placing of crypto assets;

- reception and transmission of orders for crypto assets on behalf of third parties; and

- providing advice on crypto assets.

Licensing of Crypto Asset Service Providers

In order to provide crypto asset services in Europe, the service provider must be a legal person that has a registered office in an EU Member State and will need to obtain a crypto asset service provider license under MiCA. In order to obtain such license, the service provider will have to comply with various requirements, similar to the requirements for financial services providers, including:

- Capital requirements
  (own funds or insurance in an amount between EUR 50,000 and EUR 150,000, depending on the type of service)

- Organizational requirements
  (ownership, personnel, cyber-security, record keeping, conflicts of interest)

- Business conduct requirements
  (to act honestly, fairly and professionally and in the best interest of clients)

Investment firms that are authorized under MiFID II for similar (investment) services can provide crypto asset services on the basis of the existing investment services license.

However, certain operational requirements under MiCA continue to apply to such investment firms.

Cross-Border Implications of MiCA

Passporting within the European Union

One of the key benefits of the MiCA regulation is the EU passporting regime which aims at removing the current regulatory fragmentation. A license granted to an issuer of crypto assets or a crypto asset service provider in one Member State will be recognized in all EU Member States. An issuer licensed in one Member State will therefore be able to make offerings of crypto assets or to apply for admission of crypto assets for trading in all Member States without any additional licensing requirements. Similarly, a crypto asset service provider licensed in one EU Member State will be able to provide their services in all EU Member States.

Whitepapers that have been approved by the home NCA of an issuer will be deemed to be approved by the NCA in all other EU Member States.

Application to Non-EU Issuers and Service Providers

The application of MiCA to non-EU issuers and crypto asset service providers generally follows the same rules applicable to the issuers of financial instruments and financial services providers. Issuers and service providers that are not established in the European Union will need to comply with the licensing and operational requirements under MiCA if they actively solicit clients or potential clients or promote or advertise crypto-asset services or activities in the European Union. MiCA, however, will not provide for a third-country access regime similar to what is available under MiFID/MiFIR that allows third-country firms to provide cross-border services in the Member States without being established or setting up a branch in the European Union.

As in the case of financial instruments, the principle of reverse solicitation with respect to crypto assets will also apply under MiCA. In the recitals, the European Commission expressly states that MiCA should not affect the possibility for persons established in the European Union to receive crypto asset services by a third-country firm at their own initiative. As a consequence, crypto asset services provided by a non-EU party at the own initiative of an EU person should not be deemed as provided in the European Union. However, the principle of reverse solicitation will remain subject to the interpretation of each NCA and may therefore vary in the EU Member States.

Market Abuse Rules

MiCA will provide for its own market abuse regime that mirrors the market abuse rules for financial services and activities. The regime will provide for disclosure of insider information and the prohibition of insider dealing and market manipulation.

In relation to the enforcement of the market abuse rules, MiCA takes a different approach from the Market Abuse Regulation ("MAR") and the Criminal Sanctions for Market Abuse Directive ("CSMAD"). MAR and CSMAD apply to financial instruments that that are admitted to trading or traded on a regulated market and require the Member States to impose certain minimum criminal sanctions for violations of the MAR. Under MiCA, the Member States will only be obliged to impose administrative sanctions and other administrative measures and have the right but not the obligation to impose criminal sanctions for violations of the market abuse rules.

Grandfathering

MiCA will provide for transitional provisions that will allow grandfathering for tokens that were offered or admitted to trading prior to MiCA coming into effect. Such grandfathering will only be available for tokens other than asset-referenced tokens and e-money tokens. The requirements relating to asset-referenced tokens and e-money tokens will apply from day one after MiCA comes into force.

There will also be a transitional period allowing crypto asset service providers to continue providing their services for (presumably) 18 months or until they obtain the new MiCA license. The Member States will also be authorized to introduce a simplified procedure for licensing of service providers that already were authorized to provide the relevant services under the national laws.

Outlook

MiCA certainly has the potential to harmonize the approach to crypto assets and to provide more legal certainty for the issuance of crypto assets and provision of crypto asset services within the European Union.

A key issue that remains unsolved is the EU-wide harmonization of the approach to security tokens, i.e., tokens that constitute financial instruments under MiFID II. The definition of financial instruments has been implemented by the EU Member States in

different ways. As a consequence, a token may constitute a financial instrument in some Member States but not in other Member States. Bitcoin is a prominent example for such a lack of consistency, as it is considered a financial instrument in the form of a "unit of account" under the German Banking Act but not under the regulations of the other EU Member States.

The inconsistent approach to security tokens also has significant implications for MiCA. For instance, from a German perspective, Bitcoin as a financial instrument would not fall within the regulatory regime of MiCA, but it would for most of the other Member States. The European Commission suggested an amendment to MiFID II clarifying that financial instruments also include instruments issued by means of distributed ledger technology, but this will not solve the issue. The European Commission indicated that it will also provide interpretative guidance to ensure consistency in the application of MiFID II and MiCA within the European Union. It remains to be seen if such guidance will be sufficient to achieve a harmonization for all types of crypto assets.

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Debevoise
& Plimpton

Please do not hesitate to contact us with any questions.

FRANKFURT

Klaudius Heda
kheda@debevoise.com

Jan Schoberwalter
jschoberwalter@debevoise.com

LONDON

Philip Orange
porange@debevoise.com

MOSCOW

Anna V. Maximenko
avmaximenko@debevoise.com

Elena Klutchareva
emklutchareva@debevoise.com

Evgenii A. Lebedev
ealebedev@debevoise.com

NEW YORK

Byungkwon Lim
blim@debevoise.com

Gary E. Murphy
gemurphy@debevoise.com