

Crypto Regulation: the EU's MiCA Takes its (Near) Final Shape

In brief

In October 2022, the Council of the EU published the long-awaited **compromise text** of the proposed Regulation on Markets in Cryptoassets (MiCA), a "landmark regulation" that, according to the Council, will "put an end to the crypto wild west". Although political agreement was reached at the end of June 2022, negotiations carried on through technical discussions on the text over the summer, resulting in a number of changes from the political agreement in the final compromise text. Once in force, MiCA will establish the first comprehensive, pan-EU regulatory regime for the regulation of cryptoassets, including the regulation of (i) cryptoassets issuance activities and (ii) cryptoasset service providers (who will be held to similar regulatory standards to those imposed on investment firms). The European Parliament vote on the text, originally expected to take place in December 2022, will now not take place until February 2023. That is expected to result in a delay to the entry into force of MiCA whilst also giving those interested in this area more time to study the detail of the 380-page text.

In this briefing, we highlight MiCA's main provisions and some of the key changes coming out of the compromise text when compared with earlier versions.

Tokens within scope

MiCA will apply to a wide range of cryptoassets, capturing widely-used cryptocurrencies that may be used for speculative purposes but also other tokens such as those used for payment (e.g. stablecoins) or which reference underlying assets. There are important exclusions / carve-outs for (some) NFTs as well as security tokens already captured under existing legislation, but even allowing for these exclusions, the ultimate result will be a far-reaching scope. In keeping with the EU Commission's Digital Finance Strategy, MiCA is agnostic on technology, defining "cryptoasset" as "a digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology or similar technology". MiCA will establish a pan-EU regulatory regime applying to any person providing cryptoasset services or issuing cryptoassets in or into the EU. The framework covers cryptoassets falling outside existing EU financial services legislation, and establishes a specific regulatory regime for the following stablecoins:

- e-money tokens (EMTs), which are referenced to the value of one official currency; and
- asset-referenced tokens (ARTs), which are not EMTs and which are referenced to any other value or right or a combination thereof, including one or more official currencies.

While the Commission's original MiCA proposal excluded algorithmic stablecoins from scope, the compromise text now makes clear that ARTs are defined "irrespective of how the issuer intends to design the cryptoasset, including the mechanism to maintain a stable value". This means that algorithmic stablecoins that aim at maintaining a stable value in relation to one or more official currencies or to one or several assets via protocols will fall within scope of ART requirements.

As noted, a number of cryptoassets are excluded from scope, including for example tokens that fall under existing EU financial services legislation (such as cryptoassets that qualify as financial instruments under MiFID), central bank digital currencies (CBDCs), and cryptoassets that are unique and not fungible, as further detailed below.

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NFTs

The compromise text's recitals expand on MiCA's exclusion of tokens which are commonly understood to be non-fungible tokens (NFTs) – tokens which, while perhaps traded in market places, are unique and not readily interchangeable such that the relative value of one cryptoasset cannot be ascertained by comparison to an existing market or equivalent asset. Examples of excluded NFTs given in the recitals to MiCA include "digital art and collectibles, whose value is attributable to each cryptoasset's unique characteristics and the utility it gives to the token holder" as well as "cryptoassets representing services or physical assets that are unique and not fungible, such as product guarantees or real estate".

However, the compromise text recitals also makes clear that not all NFTs should be excluded as NFTs – some NFTs have characteristics that belie their categorisation as unique and non-fungible. In particular:

- the fractional parts of excluded NFTs should not themselves be considered excluded NFTs;
- the issuance of cryptoassets as NFTs in a large series or collection tends to indicate the fungibility of those NFTs, calling into question whether they can be excluded;
- the sole attribution of a unique identifier to a cryptoasset is not enough to classify that cryptoasset as an excluded NFT; and
- for an NFT to be excluded, the rights or assets represented by the NFT should also be unique and non-fungible.

In practice, this is a significant narrowing of the exclusion for NFTs set out in Article 2 – that MiCA "does not apply to cryptoassets that are unique and not fungible with other cryptoassets" – and particular care will need to be taken to ensure that NFTs which are intended to be excluded are sufficiently within the scope of the exclusion.

ESMA is mandated to issue guidelines on the criteria and conditions for the qualification of cryptoassets as financial instruments. These guidelines will include circumstances under which cryptoassets that are otherwise considered to be unique and not fungible with other cryptoassets might be qualified as financial instruments under MiFID, in which case they will fall outside the scope of MiCA and remain regulated under the existing MiFID framework. The guidelines are due 18 months after MiCA enters into force. On the same timetable, the Commission is also mandated to consider the development of markets in NFTs and their regulatory treatment, and to consider whether further regulation is necessary.

Location requirements

MiCA applies to the issuance or offer of cryptoassets in the EU, or to the provision of services related to cryptoassets in the EU. EMTs which reference an EU currency are deemed to be offered in the EU. Cryptoasset service providers (CASPs) must be registered and authorised in the EU. While issuers of ARTs or EMTs must be established and authorised in the EU, this strict location requirement does not apply to offerors of cryptoassets other than ARTs and EMTs (as explained further under *Other cryptoassets* below).

Passporting

MiCA provides for passporting across the EU, in line with other EU Single Market measures. However, there are no provisions on third country equivalence, which may cause potential duplicative regulation issues for service providers seeking to offer services globally. In its report on the application of MiCA due four years after entry into force, the Commission is required to consider a potential equivalence regime for CASPs and issuers of ARTs and EMTs.

Third Country Firms

Third country CASPs are permitted to provide cryptoasset services in the EU on a reverse solicitation basis, where the services are provided at the own initiative of the EU client. However, it is expressly set out in MiCA that if the third country firm or anyone acting on its behalf has solicited clients or potential clients in the EU, regardless of the means of communication, reverse solicitation is not available (and notwithstanding any contractual clause or disclaimer indicating otherwise). This represents an attempt to clearly draw the boundaries of the reverse solicitation exemption under MiCA, which have been the subject of divergence and debate in relation to other EU Single Market measures; to provide further clarity and promote convergence, ESMA is mandated to issue related guidelines. It is important that CASPs located outside the EU/EEA familiarise themselves with the provisions of MiCA and consider the extent to which their activities could bring them within scope, or whether they can legitimately rely on the reverse solicitation provisions. This will be a fact-specific analysis that needs to be conducted carefully, having regard to the firm's profile within the EU/EEA, its marketing strategy, and relationships with third parties who may carry out activities on their behalf.

Issuers

Those who have followed the development of MiCA will recall that as well as its regime for CASPs, MiCA imposes requirements relating to the issuance of cryptoassets - for example, where cryptoassets are offered to the public in the EU or admitted to trading on a platform in the EU, a relevant person (e.g. issuer, offeror, or platform operator) needs to ensure that a white paper is published and notified as required to the relevant competent authority, as well as other regulatory obligations (covered further under *Other cryptoassets* below).

The regulatory requirements imposed by MiCA on issuers of ARTs and EMTs are more stringent than those imposed on issuers of other cryptoassets. In addition to the white paper requirements applicable to issuances generally, no ARTs can be offered to the public in the EU or admitted to trading on a trading platform for cryptoassets if the issuer is not established and appropriately authorised in the EU. Issuers of ARTs must comply with additional requirements under MiCA, including (among others) white paper and marketing obligations, own funds requirements, governance obligations, reserve asset segregation requirements, change in control requirements, and orderly wind-down plans. Issuers must also act honestly, fairly and professionally; communicate in a fair, clear and not misleading manner; manage conflicts of interest; and act in the best interests of the ART holders.

MiCA also contains lighter-touch requirements for small offerings of cryptoassets, and for offers marketed only to qualified investors.

Under MiCA, EMTs are deemed to be electronic money for the purposes of the E-Money Directive (EMD), and to avoid regulatory arbitrage EMT issuers must be authorised as a credit institution or as an e-money institution under the EMD. White paper and marketing obligations also apply.

Transaction cap

New in the compromise text, and the subject of contentious negotiations over the summer, is a transaction cap on ARTs and EMTs "used widely as a means of exchange". Where an ART or EMT is used widely as a means of exchange within a single currency area, transactions in that token will be limited to 1 million transactions in number and EUR 200 million in value. MiCA does not specifically define "means of exchange", though a recital indicates that the phrase is to be interpreted broadly and includes, for example, "payments of debts including those in the context of transactions with merchants". Although the transaction cap applies to all ARTs, EMTs are subject to the restrictions only where the tokens are denominated in a non-EU currency. There has been much discussion in the market on the impact that such transaction caps will have on USD denominated stablecoins and the comparative lack of liquidity in EUR denominated coins - if implemented as proposed, transactions in the largest global stablecoins may be significantly restricted or banned, with potential knock-on impact for CASPs who offer e.g. exchange against such stablecoins.

Even where these limits set down within MiCA itself are not triggered, power is given to national competent authorities to impose their own limits on the amounts of ARTs or EMTs (which limits could be lower than those set down within MiCA itself) or impose minimum denominations. These powers are exercisable where the ECB or where applicable another national central bank within the EU issues an opinion to the effect that the ART/EMT poses a threat to monetary policy, smooth operation of payment systems or monetary sovereignty (where such threat is considered serious, in the case of ARTs the ART issuer's authorisation can be withdrawn as well).

Significant ARTs and EMTs

MiCA also provides for additional regulatory requirements for ARTs and EMTs classed as significant. Under MiCA, the European Banking Authority (EBA) is empowered to classify ARTs and EMTs as significant based on satisfaction of at least three criteria, including among others the size of the customer base or the issuer's reserve, the value of the tokens issued or transactions, the significance of the cross-border activities of the issuer, or the interconnectedness with the financial system. Where an ART or EMT is deemed to be "significant", MiCA imposes additional requirements and obligations on issuers and service providers. For example, issuers of significant tokens must implement robust governance arrangements set out in a remuneration policy, establish a liquidity management policy, and comply with higher own funds requirements.

Other cryptoassets

MiCA also sets out a lighter touch transparency and disclosure regime for offers and marketing of cryptoassets other than EMTs and ARTs, for example utility tokens or algorithmic stablecoins that are not ARTs because they do not reference one or several assets. While this lighter touch regime does not include authorisation or licensing for issuers, white paper publication requirements will apply, as well as obligations to act honestly, fairly and professionally; communicate in a fair, clear and not misleading manner; manage conflicts of interest, and maintain systems and security access protocols. In addition, offerors must act in the best interests of the cryptoasset holders.

CASPs

Under MiCA, all CASPs – "legal person[s] or other undertaking[s] whose occupation or business is the provision of one or more crypto-asset services to third parties on a professional basis" – must be registered and authorised in the EU, and comply with operating and conduct obligations. MiCA's regulatory regime for CASPs draws inspiration from other authorisation regimes under MiFID and other EU legislative measures for financial services. For example, the services to be regulated under MiCA map to a certain extent those in MiFID (e.g., "the reception and transmission of orders" for cryptoassets on behalf of third parties), and the regime for offers and placings seems to be inspired by existing capital markets and transparency measures. In particular, cryptoasset services under MiCA include:

- the custody and administration of crypto-assets on behalf of third parties;
- the operation of a trading platform for crypto-assets;
- the exchange of crypto-assets for funds;
- the exchange of crypto-assets for other crypto-assets;
- the execution of orders for crypto-assets on behalf of third parties;
- placing of crypto-assets;
- providing transfer services for crypto-assets on behalf of third parties;
- the reception and transmission of orders for crypto-assets on behalf of third parties;
- providing advice on crypto-assets; and
- providing portfolio management on crypto-assets (i.e., where portfolios include one or more cryptoassets).

While MiCA is silent on the activity of crypto lending itself, both issuers of ARTs and EMTs as well as CASPs providing services in relation to ARTs and/or EMTs are prohibited from granting interest (reflecting the clear intention of EU policymakers that ARTs and EMTs should not become vehicles for savings). MiCA treats as interest any remuneration or any other benefit related to the length of time during which a holder of the tokens holds those tokens. Note, however, that Member States may choose to regulate crypto lending at the national level despite the lack of harmonisation in MiCA. It is possible, also, that lending activities in respect of cryptoassets are provided in the context of the lender carrying out one or more of the existing MiCA regulated activities due to their structure (for example, where loaned assets are held in custody), thereby triggering MiCA's authorisation provisions.

Market abuse

Closing a gap in current financial services legislation, MiCA establishes a bespoke market abuse regime for cryptoassets, drawing on concepts in the EU Market Abuse Regulation (MAR) but modified to take into account the specific characteristics of cryptoassets and crypto markets. MiCA prohibits insider dealing, unlawful disclosure of inside information and market manipulation, and expressly imposes requirements relating to systems, procedures and arrangements to monitor and detect market abuse. The market abuse provisions are not limited to ARTs and EMTs – acts relating to any cryptoasset trading on a crypto platform operated by a CASP are within scope, and the provisions apply to actions and omissions occurring anywhere worldwide, an express expansion of territorial application added in the compromise text. Note that derivatives which are MiFID financial instruments, with crypto underlyings, remain within scope of MAR when traded in a regulated market, multilateral trading facility or organised trading facility.

Sustainability disclosures

Significantly, the compromise text adds new sustainability disclosure requirements for issuers and CASPs, in response to growing concerns about the environmental and climate footprint of the sector. All white papers, including those published under the light touch regime for non-ART or EMT cryptoassets, must include information on principal adverse environmental and climate related impact of the consensus mechanism used to issue the cryptoasset. CASPs must also publish on their website the same disclosures for each cryptoasset in relation to which they provide services, which can be derived from the white papers. This will be particularly relevant, for example, in the context of cryptoassets which use "proof of work" methods (for example, in respect of generation of

new cryptoassets or validation of transactions) which may use significant amounts of computing power. Looking forward, it is possible that we may see a tightening of consensus mechanisms permissible under MiCA: in its report on the application of MiCA, the Commission is mandated to assess policy options and, where necessary, any additional measures that might be warranted to mitigate adverse environmental impacts arising from crypto technologies and, in particular, consensus mechanisms.

What's next

Although the European Parliament had been expected to consider MiCA in plenary in December 2022, this process has now been delayed to February 2023, and consequently MiCA is expected to complete the legislative process and enter into force during the course of 2023. Provisions relating to ARTs and EMTs apply 12 months later, with the remaining provisions including those on CASPs applying 18 months after entry into force. Transitional measures will apply for cryptoassets other than ARTs and EMTs trading on a platform prior to MiCA's application. CASPs operating before MiCA's application are also permitted to continue operating for up to 18 months before requiring authorisation under MiCA, although Member States may choose to shorten or remove this transitional period entirely.

Although we have highlighted the key changes to MiCA that were added between the announcement of political agreement and publication of the compromise text, there are still a number of outstanding issues to be addressed in future reports and possible legislative measures. Most notably, while NFTs are nominally excluded, as we explain above, that exclusion has been significantly narrowed and further work from the Commission on a potential bespoke regulatory regime is likely forthcoming. Additionally, while decentralised finance (DeFi) was ultimately excluded from the scope of MiCA, it is clearly on the regulatory agenda, and the Commission is required to report on the feasibility of regulating DeFi including, if appropriate, a legislative proposal. Indeed, calls for a stronger crypto regulatory framework have already been made, from key European regulators: in comments before the European Parliament on 20 June 2022, Christine Lagarde, president of the European Central Bank (ECB) and chair of the European Systemic Risk Board (ESRB), called for an expanded regulatory regime through "MiCA II" with a larger perimeter regulating activities such as staking and lending, DeFi, and the issuance of cryptoassets where there is no identifiable issuer.

In parallel, the [compromise text](#) of the proposed Regulation on information accompanying transfers of funds and certain cryptoassets was also published on 5 October 2022. The Regulation, which is expected to be adopted and apply on the same timetable as MiCA, will implement the travel rule for cryptoassets, require CASPs to have in place internal policies, procedures and controls to ensure the implementation of EU and national restrictive measures, and broaden the scope of obliged entities subject to the EU's anti-money laundering regime to include all CASPs as defined in MiCA (with the exception of those only providing advice on cryptoassets).

What firms can do now

Although the adoption of MiCA is now delayed to early 2023 (meaning implementation in 2024), there are steps that firms can begin to take now to prepare for the new regime. Firms offering crypto related services that could be impacted by the framework should conduct a detailed assessment of their current and future product offerings against the proposals, identifying gaps in organisational and systems requirements planning remedial measures to prepare for MiCA's new obligations, including group structuring and optimisation in order to benefit from the MiCA passport. Issuers and offerors of tokens should begin to consider whether and if so, how, MiCA applies to them and their tokens, with a view to justifying that position to regulators and the ESAs if required, especially while ESMA's guidelines on classification are awaited. Non-EU firms should also start to examine points of nexus to assess whether their activities might bring them within scope, and to evaluate whether there could be an advantage to setting up an EU CASP to benefit from the passporting provisions or whether they can legitimately rely on the reverse solicitation provisions. MiCA is a significant regulatory shift for the majority of firms in the crypto space so early action is advised.

Our experts are monitoring MiCA's progress and helping clients to analyse the implications of the new regime on their businesses. Please get in touch with any of the experts listed below, or your usual Baker McKenzie contact, to learn more about what MiCA means for you.



To learn more about MiCA and other developments in the crypto space, join us for Crypto Boot Camp 2022, our virtual seminar series providing insights on how the regulatory landscape is changing and discussing the future of crypto within the financial services sector. Click [here](#) to register.

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