YPOG Briefing:

The Markets in Crypto-Assets Regulation (MiCA) is here - EU framework for crypto assets with global role model potential (II)

Berlin, Hamburg, November 28, 2022 | Dr. Anika Patz, Dr. Carola Rathke

In September 2020, the first draft of the MiCA was published - after more than two years, the uniform EU framework has now taken its final shape and has the potential to become a blueprint for a global regulatory standard. In Part I of this briefing, we explained which rules apply to crypto-assets under MiCA, the requirement to produce a white paper and which rules apply to stablecoins and their issuers. Part II focuses on the obligations MiCA imposes on EU and third-country CASPs, the future regime to combat market abuse, whether DeFi applications, consensus mechanisms and NFTs will now be regulated and, last but not least, as of when MiCA becomes applicable.

Authorisation and organisational requirements for CASPs - what advantages do German companies have?

MiCA provides a harmonized framework for the authorisation and notification requirements for CASPs throughout the EU. Anyone who intends to offer crypto-asset services in the EU requires authorisation as a CASP, unless the company is already authorised to provide comparable services as a credit institution, central securities depository, investment firm, market operator, e-money institution or capital management company of UCITS or alternative investment funds.

The custody and administration of crypto-assets, 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, the placing of crypto-assets, transfer services for crypto-assets, the reception and transmission of orders for crypto-assets, providing advice on crypto-assets and portfolio management on crypto-assets will be regulated as crypto-asset services.

Custodians of crypto assets must keep their own assets and customer assets segregated. In addition, MiCA contains rules on liability for crypto custodians and imposes comprehensive requirements for the business organisation of CASPs, which are largely comparable to the requirements for investment firms. It's important to note that companies offering crypto-asset services in Germany already today need to obtain a license as a financial services institution or investment firm and must comply with the corresponding business organisation requirements under German national law. This means that companies licensed in Germany will therefore be able to transition to MiCA requirements without major adjustments, which might give them a head start. In addition, it is envisaged that service providers who already have a comparable authorisation under national law will be able to transition from their national license to a MiCA authorisation in a simplified procedure.

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Can companies operate throughout the EU and what about companies from third countries?

MiCA allows companies to offer crypto-asset services cross-border throughout the EU. This means that, unlike today, companies do not have to get registered or licensed separately in each member state where they want to provide their crypto-asset services. While they are free to set up local subsidiaries or branch offices, companies can also opt to passport their services to other EU markets on a cross-border basis from their licensed entity.

For third country firms, MiCA provides guidelines to delineate what is considered "reverse solicitation" and at what point a targeted market approach triggers licensing requirements. To the extent customers domiciled in an EU member state are using a crypto trading platform domiciled in a third country on their own initiative, this crypto trading platform does not require a MiCA authorisation.

What regulations apply with respect to market abuse?

MiCA contains a bespoke regime on disclosure of inside information, prevention and detection of insider dealing and market manipulation. CASPs involved in the arrangement and execution of transactions must put in place arrangements, monitoring systems and procedures to monitor and detect market abuse.

Are DeFi applications, consensus mechanisms and NFTs also in scope of MiCA?

Throughout the legislative process, there was a heated debate on whether non-fungible tokens (NFTs) should be covered by MiCA, whether blockchains based on the proof-of-work consensus mechanism should be banned because of their carbon footprint, and whether DeFi applications and decentralised exchanges (DEX) should be regulated by MiCA.

MiCA does not (yet) contain a separate framework for NFTs. In principle, crypto-assets that are unique and not fungible or interchangeable with other crypto-assets, including digital art and collectibles whose value is attributable to the unique characteristics of each crypto-asset and the utility it provides to the token holder, are not subject to MiCA. This also applies to crypto-assets that represent services or physical assets that are unique and non-fungible, such as product guarantees or real estate. Even NFTs that are acquired for speculative purposes or can be traded on marketplaces are not regulated by MiCA if they fulfill those requirements. However, the assessment changes if NFTs can be fractionalised or large series and collections of an NFT are issued - in these cases they most likely can no longer be regarded as unique and non-fungible.

MiCA provides that negative climate and other environmental impacts related to the underlying consensus mechanism of a DLT must be disclosed. It is also expected that more environmentally friendly consensus mechanisms will be used more widely in the future. However, a ban on certain consensus mechanisms such as proof-of-work, as was still proposed in an earlier draft of MiCA, is now off the table.

Decentralised applications or DeFi protocols are not covered by MiCA for the time being, provided they enable crypto-asset services that are fully decentralised without an intermediary.

When does MiCA apply?

MiCA enters into force 20 days after its publication in the official journal of the EU. However, this does not mean that the individual provisions are already fully applicable. Below we outline the timeline for MiCA's entry into application:

	Regarding crypto assets (other than asset referenced token and e-money token) which were admitted to trading on a trading platform **before** the date of entry of MiCA into application, operators of trading platforms must ensure by **36 months** after the date of entry into application that a crypto asset white paper, if required, is prepared, notified and published (or updated, if required)[1].	
Implementation period: 18 months	**Grandfathering period: 18 months** Applies to CASPs[2] which have provided their services legally under the laws of a member state <u>before</u> the date of entry into application	

Q1 2023
Entry into force (not fully binding yet!)
After 20 days after publication in EU Official Journal; probably end of Jan./beginning of Feb.

Q1 2024
E-Money Token and Asset Backed Token regulations become applicable (12 months after entry into force)

Q3 2024
Entry into application
Rest of MiCA becomes binding.
CASPs[2] must be fully compliant with all provisions.[3]

End 2025
End of grandfathering
Deadline to obtain MiCA license (or stop ops / go reverse solicitation only)

1 General rule behind this 36-moths-regulation: Offerors of a crypto asset (other than an asset referenced token or e-money token), persons asking for admission of a crypto asset to trading on a trading platform, and operators of a trading platform admitting a crypto asset to trading on the platform on their own initiative must prepare, notify and publish a white paper | 2 Crypto Asset Service Provider(s) | 3 Except provision to hold a MiCA license

Your contact at YPOG:

Dr. Carola Rathke
Partner, Hamburg
Financial Services | Fintech/DLT

☎ +49 406077281 106
📱 +49 151 57117484
✉ carola.rathke@ypog.law

Dr. Anika Patz
Associated Partner, Berlin
Financial Services | Fintech/DLT

☎ +49 30 7675975 30
📱 +49 171 6543610
✉ anika.patz@ypog.law