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The Legal Status of Crypto-Asset Issuers in the Light of the Proposed MICA Regulation

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Abstract

The progress of modern digital technologies raises the question on the necessity of common regulatory mechanism applicable to crypto-asset issuers and embracing comprehensive regulation of the status of all parties involved in crypto-asset trade. However, regulation of major parties provided by the V. AML Directive has been inconsistent and abstract.[1] Under pressure of policy-makers and professional community, the European Commission has come up with the long awaited draft MICA regulation[2] designed to ensure universal regulation of crypto-assets across all member states of the European Union (hereafter EU) including those of the European Economic Area (hereafter EEA). The proposed draft purports to harmonize fragmented regulation of crypto-assets which EU member states were forced to introduce for lack of EU-wise regulation of this institution. The main purpose of this paper is to analyze the newly established institutions including categorization of crypto-assets covered by MICA. The main functional aspects of the crypto-asset offering process including a requirement to publish a white paper are examined in this context. The supervisory role of the European Banking Authority (EBA) in respect of the issuers of significant crypto-assets is specifically discussed. Based on this analysis, the author concludes

[1] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.

[2] Proposal for a Regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. COM/2021/420 final.

that the application of MICA is handicapped by a number of problems discussed in more detail further on. Thus, MICA is not straightforward in its definitions of crypto-assets which are rather general, and contains no detailed explanation of cooperation between the competent authorities in the EU and third countries to prevent money laundering and terrorist financing. The following research methods were used by the author in writing the paper: formal legal method, comparison, synthesis, analysis, analogy, induction and deduction methods.

Keywords

MICA; crypto-asset; money laundering and terrorist financing; utility token; asset-referenced token; e-money token; white paper; supervision of token issuers.

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Background

On 7 May 2020, the European Commission put forward an action plan for creation of comprehensive European Union policy to prevent money laundering and terrorist financing.[3] Under the proposed plan, the European Commission was to take steps for tighter EU regulation against money laundering and terrorist financing. This was followed by four legislative proposals regarded as a single agreed package and designed to implement the EC's action plan. The package contains four proposals[4] which completely change the effective law to introduce an EU-wide code for preventing unauthorized use of the financial system for money laundering and terrorist financing.

[3] Communication from the Commission on an Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing. COM (2020) 2800 final.

[4] Proposal for a Regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. COM/2021/420 final. Proposal for a Directive of the European parliament and of the Council on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849, COM/2021/423 final. Proposal for a Regulation of the European Parliament and of the Council establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism and amending Regulations (EU) No 1093/2010, (EU) 1094/2010, (EU) 1095/2010, COM/2021/421 final. Proposal for a Regulation of the European Parliament and of the Council on information accompanying transfers of funds and certain crypto-assets (recast), COM/2021/422 final.

On 24 September 2020 the European Commission presented under the proposed plan a new Digital Finance Strategy with a focus on four main areas: overcoming fragmentation of the single digital market; adapting the EU regulatory framework to promote digital innovations; advancing data-based finance; addressing problems and risks of the digital transformation including to improve digital transactions and ensure sustainability of the financial system.[5]

The Digital Finance Strategy is largely based on the proposed MICA regulation whereby the European Commission intends to bring the EU regulatory framework in line with the FATF (Financial Action Task Force) recommendations which, in particular, define the key concepts (for instance, crypto-assets, crypto-asset service provider etc.).[6] With the EU intending to back financial sector innovations, MICA strives to support the activities of crypto-asset issuers while underlining the need to protect consumers. Thus, MICA does not concern itself with developing measures to restrict the use of crypto-assets within the EU.

As part of MICA, the European Commission introduces an individualized legal regime to remove the risks posed by crypto-assets and significant tokens.[7] Due to the similar legal nature of crypto-assets, securities and e-money, MICA includes certain provisions of the MIFID[8] and the e-money directives[9] [Hobza M., 2021: 19].

Despite that the Digital Finance Strategy is a landmark in terms of encouraging innovations and promoting digitization, MICA's definitive form is up-to-date unclear and raises a number of sufficient questions regard-

[5] Communication form the Commission to the European Parliament, the Council, the European economic and social committee and the committee of the regions on a Digital Finance Strategy for the EU, COM(2020) 591 final.

[6] FATF Report. Virtual Currencies Key Definitions and Potential AML/CFT Risks. Paris: FATF, 2014; see akso: FATF International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation. Interpretive note to recommendation 15 (new technologies). Paris: FATF, 2012.

[7] Explanatory memorandum to proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final, p. 8.

[8] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

[9] Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC.

ing its relevance and formal adequacy. The ambiguity and inconsistency of MICA's legal form are noticeable throughout its content.

1. The scope of MICA

The draft of MICA regulations applies to the offering of crypto-assets and provision of related services in the EU[10] meaning that MICA largely covers the territory of the EU. However, the draft of MICA regulation is also important for the EEA and its relevant provisions are thus equally applicable to EEA member states [Ferreira A., Sandner P., Dünser T., 2021: 23].

Since crypto-asset offering is a rather broad area, there are certain exemptions from the proposed MICA regulation for the most part related to operations subject to other regulations (for example, MIFID, e-money and deposit guarantee schemes directives[11] etc.). Digital currencies of central banks are equally exempt provided that these are crypto-assets issued by central banks in the capacity of a monetary authority. Other exemptions include, for instance, the European Investment Bank, insurance companies, public international organizations etc.[12]

Currently, the EU adopts the technological neutrality principle[13] whereby the issuer may choose the technology to use, with a majority of crypto-assets relying on the distributed ledger technology ("DLT"). As the V. AML directive, apart from this requirement, provides no explanation of this concept, we have to turn to the eIDAS directive[14] where the technological neutrality is understood as the absence of requirement to use specific national technology for electronic identification in a particular EU member state.

[10] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 2 (1).

[11] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance.

[12] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets and amending Directive (EU) 2019/1937. COM (2020) 593 final. Art 2 (3).

[13] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU. Recital 22.

[14] Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market and repealing Directive 1999/93/EC. Art 12 (3) (a).

In the DLT context, MICA applies the term "distributed ledger technology" which means the one supporting distributed data encryption.[15] The DLT facilitates digital identification [Zetzsche D., Arner D., Buckley R., Weber R., 2020: 334]. In this case, it should be underlined that most DLT technologies will relate user accounts not to their real identification data but to an account ID functioning as an alias [Moreno S., Seigneur J., Gotzev G., 2020: 9]. DLT is characterized by totally or almost decentralized management and fully decentralized record keeping [Zetzsche D., Arner D., Buckley R., 2020: 180, 334].

2. Types of crypto-assets

Compared to the original, currently effective V. AML regulation, MICA offers a totally different classification of crypto-assets divided into a number of specific types of tokens.

The original term "virtual currency" defined in paragraph 18, Article 3 of V. AML thus gives place to the general term "crypto-assets". Compared to the former, the latter is a much broader term which, apart from digitally representing a value, represents to some extent the rights related to ownership of crypto-assets.

Based on the definition of crypto-assets, the following three sub-categories of tokens are distinguished:

utility token ("UT");

asset-referenced token ("ART");

e-money token ("EMT").

MICA envisages the emergence of new technologies in the future and therefore gives the European Commission broader powers to be able, as necessary, to adopt delegated acts for amending the original definitions of the terms in line with the market development and technological change.[16] This competence allows MICA to be flexible in responding to future innovations and changes to the core elements of adaptable concepts.

2.1. Utility token

While not normally regarded a traditional form of security or financial product, UT is a crypto-asset type which provides digital access to a com-

[15] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. COM (2020) 593 final. Art 3 (1).

[16] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. COM(2020) 593 final. Art 2 (2).

modity or service available via DLT, with their acceptance linked to the given token's issuer.[17] UTs serve non-financial purposes primarily related to the use of digital platforms and digital services. Thus, UTs are designed to support the functionality of blockchain-based systems rather than generate future cash flows [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 206].

UTs can also provide a means of exchange which, unlike ARTs or EMTs, is not linked to any asset. One example is bitcoin which is not linked to any legal tender or other type of commodity [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 212 — 213]; [Irwin A., Turner A., 2018: 299]. It is obviously bitcoin that is targeted by Chapter II of the MICA regulation.

While Chapter II entitled "Crypto-assets other than asset-referenced tokens or e-money tokens" makes no reference to UTs ("other crypto-assets"), it is this chapter that regulates UTs [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 211]. The use of a different term ("crypto-assets other than asset-referenced tokens or e-money tokens") probably reflects an attempt to embrace all currently existing and future types of tokens not detailed in the proposed MICA regulation.

The provisions of Chapter II contain general regulation of UT trading. Primarily targeting issuers of "other crypto-assets", these provisions introduce a number of eligibility requirements to issuers wishing to offer the said crypto-assets to the public or seeking their admission to a trading platform in the EU.

One of the requirements concerns the status of crypto-asset issuers which should be established as a legal entity. In fact, each issuer trading in crypto currencies through a platform should be a legal entity. Apart from this general requirement, no form of incorporation or reference to a draft or amendment to the relevant EU legislation is mentioned. Theoretically, it means the issuer can be established as a limited liability company. While we cannot judge what was the legislator's original intention, we believe it would be feasible, in order to reduce a higher risk involved in crypto currency trade, to opt for the joint-stock company as a form envisaging tighter requirements, in particular, to capital since this would finally ensure better protection of crypto-assets held by consumers.

Issuers of other crypto-assets are basically supervised by competent authorities of their home EU member state meaning the member state where they have their registered address as a legal entity. It is the competent au-

[17] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. COM(2020) 593 final. Art 3 (1) (5).

thority of the home EU member state that is required to notify the white paper to the European Securities and Markets Authority ("ESMA"). The ESMA will provide public access to the white paper in the register of crypto-asset service providers.[18]

The proposed MICA resolution adopts a specific approach to the question of the issuer offering "other crypto-assets" to the public or seeking their admission to a trading platform. In this case, the territorial principle is applied, with the home EU member state advising the host EU member state of the issuer's intention.[19] The host EU member state is the one in whose territory the issuer is about to offer its crypto-assets.

In the context of these conclusions, it becomes obvious that the issuers of "other crypto-assets" are supervised at the level of EU member states which raises the question of cooperation with third countries. As the relevant MICA provisions do not address this question in detail, we take the recital as the starting point which says that the issuers established in a third country should notify their white paper to the competent authority of the EU member state where the crypto-assets are to be offered or where the admission to trading on a trading platform for crypto-assets is sought in the first place.[20]

2.1.1. White paper

One of the main requirements to issuers of other crypto-assets concerns the drafting, notification and publication of a "white paper". The content of the latter is detailed in paragraph 1, Article 5 of the MICA regulation.

The rules to draft and publish "white paper" are not principally different from those of a prospectus. Moreover, the fact that the implementation powers specified in Chapter II are assumed by the ESMA makes the similarities between the "white paper" and the prospectus even more striking [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 211].

In fact, the proposed MICA regulation contains a number of statements advising consumers of the risks involved, so that they are not mislead with regard to the legal classification of crypto currencies. For instance, MICA

[18] For details of the register of crypto-asset service providers see: Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. COM(2020) 593 final. Art 57.

[19] Ibid. Art 7 (4).

[20] Ibid. Recital 18.

requires to notify the consumers that the "white paper" was not reviewed or approved by any competent authority in any EU member state.[21] At the same time, the issuer is required to state that the white paper is not a prospectus and that crypto-assets are not regarded as financial instruments.

In this regard, the "white paper" should not contain any assertions on the future value of crypto-assets, unless the issuer of such "other crypto-assets" can explicitly guarantee their future value.[22]

In fact, it is the risk involved in crypto-asset trading that has forced to introduce additional responsibility of the issuer of "other crypto-assets" for the information contained in the "white paper". If the information is incomplete, false or misleading, the issuer will compensate for the damage caused to the crypto-asset holder. The issuer's liability allows no exclusion.[23] In this case, there is no liberal reason (such as force-majeure circumstances) which would waive the issuer's liability for the caused damage. Thus, once the crypto-asset holder provides evidence of violation of the provisions, the issuer will be liable to compensate for the damage. However, it is worth noting that the issuer's absolute liability does not apply to the summary deemed to be part of the "white paper".[24] In this case, the legislator does not allow to claim damages caused by the information contained therein.

With reference to the EU's original intent to support innovations in the financial sector, the MICA regulation contains a list of exclusions in paragraph 2, Article 4 which exempt crypto-asset issuers from the requirement to draft, notify or publish a "white paper". In doing this, the legislator obviously wished to reduce the burden on smaller issuers trading in such crypto-assets. Some of the exclusions reflect the core principle of proportionality to stress that the proposed rules should be limited to what is required to achieve the draft's purpose.[25]

The principle of proportionality also applies to MICA provisions on no ex ante approval of a "white paper" to be sought from the competent authority of the home EU member state [Bočánek M., 2021: 43]. At the same time, issuers are required to notify the "white paper"'s content to the

[21] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. COM(2020) 593 final. Art. 5 (3).

[22] Ibid. Art. 5 (4).

[23] Ibid. Art. 14.

[24] Ibid. Art. 22 (3).

[25] Explanatory memorandum to proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. COM(2020) 593 final, p. 5.

competent authority of the home member state 20 business days before the publication date. The notification must explain to the competent authority why the offered crypto-asset is qualified as such (and not as some other financial instrument).[26]

Since there is no ex ante approval of the "white paper", the question is whether the proposed regulation is feasible. The argument to avoid overload on the competent authorities is inherently weak in view of the high risks involved. It is theoretically possible that a person interested in crypto-assets may be given different versions of the "white paper", for example, due to a sudden partial change of its content, only to make the purchase of such crypto-assets more problematic. Therefore, we believe it is feasible to revisit the issue of ex ante approval by the competent authority to ensure adequate integrity and certainty through EU-wide regulation [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 212].

2.2. Asset-referenced token

ARTs are defined as "a type of 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".[27] In this case, tokens linked to a basket of currencies, commodity types or crypto-assets are meant [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 212]. The stable value of such tokens allows holders to use them as a legal tender for purchase of goods and services or for saving.

To offer such tokens or apply for admission of such assets to a trading platform, the ART issuer must have an authorization issued by the competent authority of the home EU member state. The authorization should be issued by the EU member state where the issuer has a registered address as a legal entity. The content of an application for authorization is detailed in Article 16, one of the main requirements being the white paper submitted to the competent authority for approval.

The issued authorization is subject to the principle of single European passport otherwise called passporting. This principle means that the autho-

[26] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. COM(2020) 593 final. Art 7 (1–3).

[27] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 3 (3).

rization will take effect in the territory of all EU member states [Winkler M., 2004: 705]. Also, the passporting principle applies to the content of the proposed "white paper".

This is a major change, with the currently effective voluntary registration giving place to mandatory registration. Compared to V. AML[28] which did not explicitly require issuers to obtain authorization for the given type of business, the new regulation represents a higher level of harmonization to introduce a single access point to the financial market. However, it should be stressed that in spite of these advantages, the authorization is likely to be more cumbersome to obtain for smaller token issuers.

The proposed MICA regulation also contains a number of exclusions from the authorization requirement. Thus, no authorization is required for issuers holding a banking license[29], offering tokens exclusively to qualified investors etc.[30] However the fact of not being obliged to seek authorization does not waive the ART issuer's obligation to publish a "white paper".

The process of authorization can be divided into two stages:

applying for authorization;

making a decision to issue or deny authorization.

At the first stage, the competent authority of the home EU member state will check the submitted application and its necessary annexes for completeness. Then the competent authority will assess the ART issuer's compliance with the effective requirements over three months to make a well-founded draft decision to issue or deny the sought authorization.

At the second stage, the competent authority will provide their draft decision to issue or deny authorization including requests for opinion addressed to the EBA, ESMA and ECB (European Central Bank), with the said agencies to propose their non-binding opinion to the competent authority within two months. The competent authority will make the final decision to issue or deny authorization based on this opinion. Where the

[28] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU. Recital 9.

[29] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC. Art 8.

[30] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 15 (3–4).

ART issuer's application has been satisfied, the authorization will be added to the register of crypto-asset service providers maintained by the ESMA.

The competent authority may withdraw the authorization where the issuer no longer complies with any of the requirements envisaged by paragraph 1, Article 20 of the MICA regulation — for instance, if the issuer no longer complies with all of the qualification requirements etc.

The authorization process is explicitly linked to ART issuers' obligation to draft and publish a "white paper". Under paragraph 1, Article 17 of the MICA regulation, ART issuers, unlike issuers of "other crypto-assets", while not required to advise consumers of review and approval of the "white paper" by the competent authority of their home EU member state, have to describe, among other things, their reserve of assets. The "white paper" is deemed automatically approved if the issuer has received the authorization for public offering of ARTs or admission to the trading platform. In this context, ART issuers have to seek the approval of their white paper by the competent authority of the home EU member state.

The requirement to seek the approval of a white paper has been added to ensure the protection of consumers and market integrity from higher risk associated with ARTs compared to "other crypto-assets" which follows from their possibly broader use (for instance, as a legal tender).

As in the case of "other crypto-assets", the information on future value cannot be part of a white paper. Also, ARTs come under certain exclusions envisaged by paragraph 2, Article 4 of the MICA regulation which exempt ART issuers from the requirement to draft and publish a "white paper".

2.2.1. Governance arrangements and capital requirements

ART issuers should have robust governance arrangements including a clear organizational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which they are or might be exposed, and adequate internal control mechanisms, including sound administrative and accounting procedures.

There is a special requirement applicable to members of the management body of ART issuers. In the first place, they should have good repute, competence and experience. At the same time, the said members should provide evidence that they were not convicted of offences relating to money laundering or terrorist financing or other financial crimes. There require-

ments also apply to natural persons holding a qualified stake in the ART issuer or otherwise exercising a power of control over such issuer.[31]

In order to reduce the existing risks, ART issuers should have internal control arrangements as well as risk assessment and management procedures. This implies the use of RBA (risk-based approach) based on FATF Recommendations.[32]

In order to offer crypto-assets, ART issuers should have in place own funds of EUR 350,000 or 2% of the average amount of the reserve assets calculated as of the end of each calendar month over a prior six-month period.[33]

Apart from the obligation to have in place own funds, ART issuers are required to have and maintain reserve of assets. Reserve assets are a group of currencies which are legal tenders, exchange traded commodities or crypto-assets underlying the value of ARTs and available for investment. If several ART categories have been issued, the average amount of the reserve assets should be maintained in respect of each category.

The EU member state hosting the ART issuer may decide to increase/decrease the said percentage requirement to the average amount of the reserve assets by maximum 20% depending on the assessment of specific facts indicating a higher or lower risk. These facts may assume, for example, the quality and volatility of the reserve assets or the aggregate value and number of transactions carried out in ARTs.[34] This raises the question: whether a higher percentage requirement will not prevent smaller players from accessing the market. The proposed burden may prove to be cost-prohibitive to them.

Issuers are required to keep a reserve of assets separately from own funds. Based on a contract concluded in advance, the issuer should keep the reserve assets in custody with a crypto-asset service provider or a credit institution. The choice of a custodian will depend on the type of the reserve assets to be kept in custody. While credit institutions accept fiat currencies, financial instruments and other assets, crypto-asset service provides will not keep in custody anything other than crypto-assets.

[31] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 30 (2–4).

[32] FATF International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, Interpretive note to recommendation 15 (New technologies). Paris, FATF, 2012, p. 10.

[33] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 31 (1).

[34] Ibid. Art 31 (3).

Credit institutions and crypto-asset service providers are liable for possible loss of financial instruments or crypto-assets placed in their custody and will be obliged to return to ART issuers a financial instrument or a crypto-asset of an identical type or the corresponding value. To waive this liability, the legislator envisaged a classical liberal basis whereby a credit institution or a crypto-asset service provider may prove that the loss has resulted from an external event beyond their reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts.[35]

Pursuant to Article 34 of the MICA regulation, ART issuers may invest a part of their reserve assets in highly liquid financial instruments. Such investments should be capable of being liquidated rapidly, with all losses and risks involved to be borne by ART issuers.

ART issuers are prohibited from paying interest throughout the term in which consumers are in possession of such tokens.

2.3. E-money token

The EMT means a type of 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.[36] Thanks to this broad concept, the legislator has covered a majority of crypto-asset types compatible with the above requirements.[37]

Compared to ARTs, EMTs are primarily designed to be a legal tender for the purchase of goods and services, with a stable value to be maintained through a link to only one fiat currency.[38]

Issuers of such tokens should comply with the three main requirements:[39]

be authorized as a credit institution or an electronic money institution;

comply with requirements applying to electronic money institution;

publish a white paper.

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[35] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 33 (8).

[36] Ibid. Art 3 (4).

[37] Národná banka Slovenska. Prehľad trhu s kryptoaktívami v Slovenskej republike. November 2020, p. 6.

[38] Ibid. P. 5.

[39] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 43 (1).

Unlike ARTs, no specific authorization is required in this case. Thus, the EMT offering is based on the existing regulation of credit institutions and on regulation of electronic money institutions.

The term credit institution means a company operating to accept deposits and other refundable monetary funds from the population as well as to issue credit at its own expense.[40] An example of credit institutions is a bank.

An electronic money institution is a legal entity authorized to issue e-money on the basis of compliance with specific requirements.[41] While e-money[42] is not conceptually identical to EMTs, the latter was associated with e-money to apply this concept[43] [Sidak M., Slezáková A., 2014: 105].

Authorization depends on compliance with the established requirements to be regulated in more detail by specific provisions. In case of a credit institution, the list of requirements depends on regulation applicable in specific member states.[44] This rule also applies to electronic money institutions which should comply with the requirements detailed in the relevant national law of the specific EU member state.[45]

Like in the case of ARTs, MICA contains a number of exclusions regarding authorization of EMT issuers. Thus, EMT issuers are exempt from authorization if e-money tokens are offered exclusively to qualified inves-

[40] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012. Art 4 (1).

[41] Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC. Art 2 (1).

[42] Pursuant to Art 2 (2), Directive 2009 mentioned, amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, e-money is a monetary value maintained in electronic form (including magnetic records) which constitutes the issuer's obligation to accept money to perform payment transactions as defined by Art 4 (5), Directive 2007/64/EC and which is accepted by other natural persons or legal entities different from the issuer of e-money.

[43] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 43 (1).

[44] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC. Art 8 (1).

[45] For instance, the Slovak Republic applies para 82, Law No. 492/2009 Z. z. on payment services and amendments to specific laws (zakon č. 492/2009 Z. z. "O platobných službách a o zmene a doplnení niektorých zákonov").

tors or their amount does not exceed EUR 5,000,000 over a period of 12 months.[46]

Apart from compliance with the said requirements, issuers should also comply with other requirements detailed in Chapters II and III of the e-money directive.

In contrast to ARTs, there is no requirement to have in place and keep in custody any reserve assets.

Moreover, pursuant to Article 49 EMT issuers may invest the funds received in exchange for EMTs in secure, low-risk assets denominated in the same currency as the one referenced by the e-money token. The list of such secure, low-risk assets is regulated by paragraph 2, Article 7 of the e-money directive with reference to annex I of the voided directive on capital adequacy of investment firms and credit institutions[47]. The legislator will obviously need to remove the reference to voided directives and replace them with those to effective regulations.

EMT issuers are prohibited from paying interest throughout the term in which consumers are in possession of such tokens, a requirement reflecting Article 12 of the e-money directive. The prohibition to pay interest is designed to make sure EMTs are used as a legal tender rather than a value saving instrument. In other words, it is an attempt to separate tokens from securities covered by a different regulatory domain [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 216].

ART issuers are also required to publish "white paper" by notifying the relevant authority of their home EU member state in advance. Like in the case of issuers of other crypto-assets, the EMT "white paper" is not subject to ex ante approval by the competent authority of the home EU member state.

3. The EBA supervisory objectives in respect of significant token issuers

3.1. Significant tokens

The EBA will supervise the issuers of significant ARTs and EMTs.

The EBA will classify ARTs as significant depending on whether issuers meet at least three main criteria. A more detailed list of criteria is provided

[46] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 43 (2).

[47] Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions.

in paragraph 1, Article 39 of the MICA regulation — for instance, the size of the issuer's reserve assets, the value of the tokens issued etc. In this case, the proposed regulation has only a general list of criteria without specifying them in detail. Further detailing of these criteria will be provided by delegated acts which the European Commission is authorized to issue.

The EBA's decision will depend on whether the issuer meets the above criteria as reported by the competent authority of the home EU member state. Based on the analysis of information provided, the EBA will or will not classify the given ART as significant. The EBA will then issue a draft decision to be notified to the ART issuer and the competent authority of the EU member state, with the supervisory function to be delegated to the EBA in cooperation with the relevant authority of the home EU member state. In this case, supervision of significant tokens will be exercised exclusively by the EBA.

Under the proposed MICA regulation, ART issuers may wish to classify their tokens as significant. In this case, they should demonstrate, through a programme of operations including the applicable business model, that the tokens meet at least three of the required criteria. Based on the provided information, the EBA will or will not classify such tokens as significant.[48] In light of the above it is obvious that if the EBA does not classify a token as significant, the issuer will continue to be supervised by the home EU member state.

Apart from general requirements, the issuers of significant tokens are required to meet additional requirements which, unlike those of ART issuers,[49] mainly differ in that the average amount of the reserve assets is increased from original 2% to 3%.[50]

As in the case of ARTs, EMT issuers are required to meet at least three criteria detailed in Article 39 of the MICA regulation.

The process whereby the EBA will classify EMTs as significant is similar to that applying to ARTs.

The main differences from ARTs manifest themselves in the following. In the first case, we deal with voluntary classification of tokens as significant. To apply for such classification, issuers need to be authorized as a banking institution or an electronic money institution.

[48] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 40.

[49] See part 2.1 of this paper for more detail on the main requirements to issuers.

[50] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 41 (1).

Another difference is that the list of additional requirements applicable to EMT issuers has been changed. For instance, EMT issuers are required to have in place and hold in custody the reserve assets capable of being invested,[51] with the requirement of 3% of their average amount to be observed in this case. [52]

In view of a broader use of significant EMTs as a legal tender and the risks they may pose to sustainability of the financial system, it was necessary to double the supervision over EMT issuers, to be ensured jointly by the competent authority of the home EU member state and the EBA.

3.2. Consultative college

Once a decision is made to classify tokens as significant, the EBA will establish a "consultative college" for each issuer of such tokens. The college will consist of a number of agencies (for instance, EBA, ESMA, ECB, competent authority of the EU member state) as well as the competent authorities of the most relevant crypto-asset service providers etc.[53] However, there is no definition of the most relevant entity in the proposed MICA regulation. In this context, paragraph 6, Article 99, and Article 101 underline the need in draft regulatory standards to be developed by the EBA in cooperation with ESMA and the European System of Central Banks to specify the conditions under which such entities are to be considered as the most relevant.

The core objectives of the college are:

issue opinions to be used as supporting materials to the proposed draft white paper etc;[54]

exchange information;[55]

agree on delegation of the main tasks to college members.[56]

The EBA will also charge a fee to reimburse a competent authority for costs incurred as a result of supervision of significant token issuers. The

[51] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 33 and 34.

[52] Ibid. Art 52.

[53] Ibid. Art 99 (2) and 101 (2).

[54] Ibid. Art 100 (1) and 102 (1).

[55] Ibid. Art 107.

[56] Ibid. Art 120.

amount of the fee charged on ART issuers should be established pro rata to the amount of their reserve assets while that charged on EMT issuers pro rata to the amount of their outstanding e-money.

3.3. Powers of the EBA in respect of significant token issuers

To supervise the issuers of significant token, the EBA has the power to perform inspections, for instance, by summoning the issuers to provide explanations, orally or in writing, on the subject of review, or to check whether issuers comply with all requirements established by relevant regulations etc.

The EBA has the power of on-site inspection at all offices of issuers, as may be necessary, to be performed on the basis of a relevant decision adopted by the EBA. The decision should specify the subject, reason and date of inspection as well as sanction in the form of a penalty for refusal to cooperate with the EBA. The amount of penalty will depend on the extent of violation of the applicable MICA provisions [Winkler M., 2018: 290].

The EBA is required to notify the inspection to the competent authority of the EU member state where the issuer holds its registered address. For adequate and efficient control, the EBA may perform on-site inspection without prior advice to the issuer.

On-site inspection should be performed by officers or other persons authorized by the EBA on the basis of a permission in writing. Should the issuer oppose to on-site inspection, a competent authority of the home EU member state should render the necessary assistance to the officers or ask the police for help.

The legality of decisions made by the EBA can be verified only by the European Court of Justice.[57] Courts at EU member states have the right to request the EBA to provide information on suspected infringement of the MICA regulation including on the status of suspects.

The EBA may apply administrative sanctions to issuers for infringement of MICA, with the form of administrative liability detailed in Annexes V and VI. The EBA may simultaneously apply one or more forms of administrative sanctions.

[57] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC. Art 61.

The forms of applicable administrative sanctions depends on the type of tokens. The range of administrative liability envisaged by the legislator in respect of ARTs is rather broad compared to EMTs where a narrower list of possible sanctions is specified. Thus, the EBA may prohibit an issuer of significant ARTs from offering such tokens, withdraw its authorization etc. In the case of EMT issuers, the EBA may apply a penalty to a significant token issuer for a failure to comply with all requirements.[58]

4. Practical problems related to the implementation of MICA

The draft MICA resolution will put in place novel and at the same time broad regulation of crypto currency trade. In this context, we note a number of practical problems which are likely to arise in the course of its implementation.

Classification of crypto-assets. Overall, the classification of crypto-assets proposed in MICA would cover a majority of the existing tokens. However, hybrid tokens combining the features of several tokens might be difficult to classify. In this case, each EU member state may have its own classification of such tokens — for instance, as financial instruments, e-money or exchange traded commodities [Burilov V., 2019: 164–165]. At the same time, it will be necessary to identify whether a given crypto-asset falls within the scope of the MIFID or e-money directive. In this case, there is a doubt whether specific directives rightly apply to hybrid tokens. [Blandin A., Cloots A. Et al., 2019: 18]; [Ferrari V., 2020: 329].

Broad definitions of tokens. The legislator's attempt to cover a broad range of specific crypto-asset types with specific notions has equally resulted in a practical problem, only to make it difficult to apply the proposed notions to hybrid tokens.

Another matter of concern is the change regarding the notion of UTs. Once introduced by paragraph 5, Article 3, it is no longer used in other provisions which adopt instead a new term — particularly, other crypto-assets — not defined anywhere in the text. Judging from the professional literature, one would suppose other crypto-assets will be an equivalent of UTs [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 211].

[58] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 112 (1–2).

It should be underlined in this regard that pursuant to paragraph 2, Article 3 the legislator empowers the European Commission to adopt delegated acts to specify technical elements of specific types of crypto-assets. The European Commission may thus amend the original definitions of token types with the purpose of improving and adapting them to the evolving crypto-asset market and technological change. At the first glance, this MICA provision is fairly reasonable and future-focused but, on the other hand, we cannot but endorse the opinion on the existence of practical problems in this domain.

Since there are currently more than 8,000 types of crypto-assets in the world, it would be obviously hard to deal with all their specific features at a time. The amended notions should be, on the one hand, fairly broad and abstract to cover these different types and, on the other hand, accurate, so as to close loopholes for possible infringement of law. Where the existing definitions are amended or extended, it will be also necessary to amend or expand the range of powers of the regulatory authorities in EU member states. In view of the above, we deal with the problem related to the length of the legislative process and the willingness of EU institutions to amend the already effective and time-tested legal acts [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 220–221].

Authorization and approval of a "white paper". While the issuers of ARTs and EMTs should be authorized to offer their tokens, no such authorization is required for UTs. A similar approach applies to drafting and publication of a white paper where UT issuers are not required to seek authorization of the competent authority while ART and EMT issuers are. This approach can finally aggravate the risk of the issuer going back on its original decision to offer ARTs and EMTs precisely because of this regulatory burden including a stricter form of supervision by competent authorities of EU member states.

Drafting/publication of a "white paper". There is inconsistent regulation as regards exemptions for smaller issuers. In the case of other crypto-assets, the proposed regulation exempts issuers from drafting/publishing a white paper provided that the total outstanding crypto-assets offered in the EU over one year do not exceed EUR 1,000,000 or the offered crypto-assets can only be held by qualified investors.[59]

This exclusion also applies to ART and EMT issuers which do not need an authorization to do business. The exclusions will apply to small issuers,

[59] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM(2020) 593 final. Art 4 (2).

once the average outstanding amount of tokens over a period of 12 months calculated at the end of each calendar day does not exceed EUR 5,000,000 or once ARTs are offered exclusively to qualified investors.[60]

A comparison of the exclusions mentioned above makes it obvious that ART and EMT issuers are not exempted from the requirement to draft and publish a "white paper". Thus, even small issuers for whom no authorization is required must draft and publish a "white paper". This interpretation will introduce, to say the least, unfair regulation concerning the drafting of a white paper, and pose the question of whether such regulation is appropriate [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 222 — 223].

Cooperation with third countries. MICA covers exclusively the territory of the EU and EEA. Since crypto-asset trade is not limited to the territory of the EU [Houben R., Snyers A., 2018: 11], the question is whether this is appropriate. Cooperation with third countries is only mentioned in Article 90 which authorizes competent authorities of the EU member states to conclude cooperation arrangements with supervisory authorities of third countries concerning the exchange of information and the enforcement of obligations arising under the MICA regulation in third countries. The role of the EBA and ESMA is to coordinate the development of such arrangements. As such, the ESMA is expected to draft technical regulatory standards containing a template document for cooperation arrangements. In our opinion, this is a complicated and rather cumbersome method of establishing cooperation, unless the core aspects of the content of such arrangements are specified in the first place.

Another question concerns the position of third countries as members of the Consultative College to be established by the EBA for issuers of significant tokens. The College members can include relevant supervisory authorities of third countries, once the EBA has concluded administrative agreements with them under Article 108 of the MICA regulation. The College members from EU member states have the right to vote for or against a joint decision of the College while supervisory authorities of third countries don't. In this case, it is not quite clear why the legislator, in proposing membership to supervisory authorities of third countries, did not give the voting right at the same time. Obviously, the decisions to be passed by the College will not be enforced by third countries despite the membership [Ferreira A., Sandner P., Dünser T., 2021: 1].

[60] Ibid. Art 15 (3) (a) and 43 (2) (b).

Decentralized issuance of crypto-assets. A fundamental problem related to MICA's application is decentralized issuance of crypto-assets where issuers are not identified in the first place [Zetzsche D., Arner D., Buckley R., Annunziata F., 2021: 224]; [Hornuf L., Kück T., Schwienbacher A., 2021: 13]. It is expected that each issuer will disclose its identity in the interest of transacting in crypto-assets and will meet all requirements established by the MICA regulation at the same time. Obviously, the decentralized issuance of crypto-assets will pose a serious and currently unsolvable problem of finding a way to force such issuers to seek authorization and submit themselves to the supervision of competent authorities.

Conclusion

Inadequate regulation of crypto-assets still observed in the EU has been a cause of shadow environment for crypto-asset business which has not yet been subject to strict control. The proposed MICA regulation is expected to fill the existing gap in this area, in the first place through unification of new institutions, such as ARTs or significant tokens. There is obvious progress, particularly regarding perception of specific tokens which have been so far understood under the V. AML directive as a kind of virtual currency exchangeable for fiat currencies or other types of virtual currencies.

The draft MICA resolution can be considered one of the most ambitious projects in the EU. At the same time, it cannot be neglected that MICA is a combination of already effective and time-tested regulations closely related with crypto-asset trade. In this regard, it is similar to MIFID and e-money directive whose provisions were partially borrowed word for word or partially amended and adapted to the process of crypto-asset trade.

Based on the above analysis, it can be concluded that, once applied in its current form, MICA is likely to raise criticism on the part of both EU member states and professional community. In terms of application, the main problems concern the classification of tokens which is inadequate and likely to apply to all categories of crypto-assets in the future. The authorization requirement applicable to ART and EMT issuers also raises the question of possible evasion of law and choosing UTs as an easier option. Obtaining a banking license is fairly cumbersome for a credit institution wishing to issue only ARTs and EMTs. As an extra benefit, UTs do not require to seek the approval of a white paper and are much easier to deal with as UT issuers are not subject to strict control and additional requirements. While we understand the legislator's attempt to tighten the regulation of ARTs

and EMTs as coming into direct contact with the EU's real economy, we disagree with a totally different form of regulation and higher regulatory burden on ART/EMT issuers. This stance could eventually slow down the development and innovation in digital technologies — precisely as a result of the excessive burden on those interested in crypto-asset trade. The problem of non-exemption of small ART and EMT issuers from the requirement to publish a white paper is manifested in a similar way, only to stress the difficulty of meeting the established requirements compared to UTs.

Last but not least, there is inadequate regulation of the cooperation with third countries restricted to possible cooperation arrangements to be concluded between competent authorities of EU member states and such third countries. In view of the global scope of crypto-asset trade, this method of cooperation appears especially deficient. There is an obvious need to raise the question of deeper cooperation at the level of the EU institutions. Therefore, we believe it necessary to establish a common and specific procedure for cooperation with third countries whereby the latter would have the same rights as the respective EU member states.

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