XReg.Consulting

Crypto-assets caught by TradFi regulation in the EU

MiCA WEBINAR 2

22 February 2024

What we'll cover

1. Welcome & housekeeping
2. Intro to XReg
3. Quick overview of MiCA, MiFID II, ESMA consultation
4. Overview of asset categories
5. Key categories
6. Other categories
7. Next steps and conclusion
8. Q&A

Who is XReg Consulting?

A public policy and regulatory affairs consultancy specialising in crypto

We help:

- crypto-asset businesses thrive and follow the rules
- governments formulate sound policy
- regulators supervise effectively
- public authorities build capacity

Over 20, mainly former regulators and government policy officials, operating around the world

Your presenters



Ernest Lima
Partner



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Senior Consultant

Quick MiCA Recap

- Markets in Crypto-assets Regulation (MiCA)
- Covers:
    1. Issuers of crypto-assets
    2. Crypto-asset service providers (CASPs)
- Intends to capture crypto-assets outside the scope of EU law
- In force since 30 June 2023
- Applies for CASPs on 30 December 2024

MiFID II Overview

- Markets in Financial Instruments Directive II (MiFID II)
- Covers:
    1. Investment intermediaries
    2. Securities markets
    3. Trading venues
- Services and activities similar to MiCA's
- Covers different types of assets than MiCA

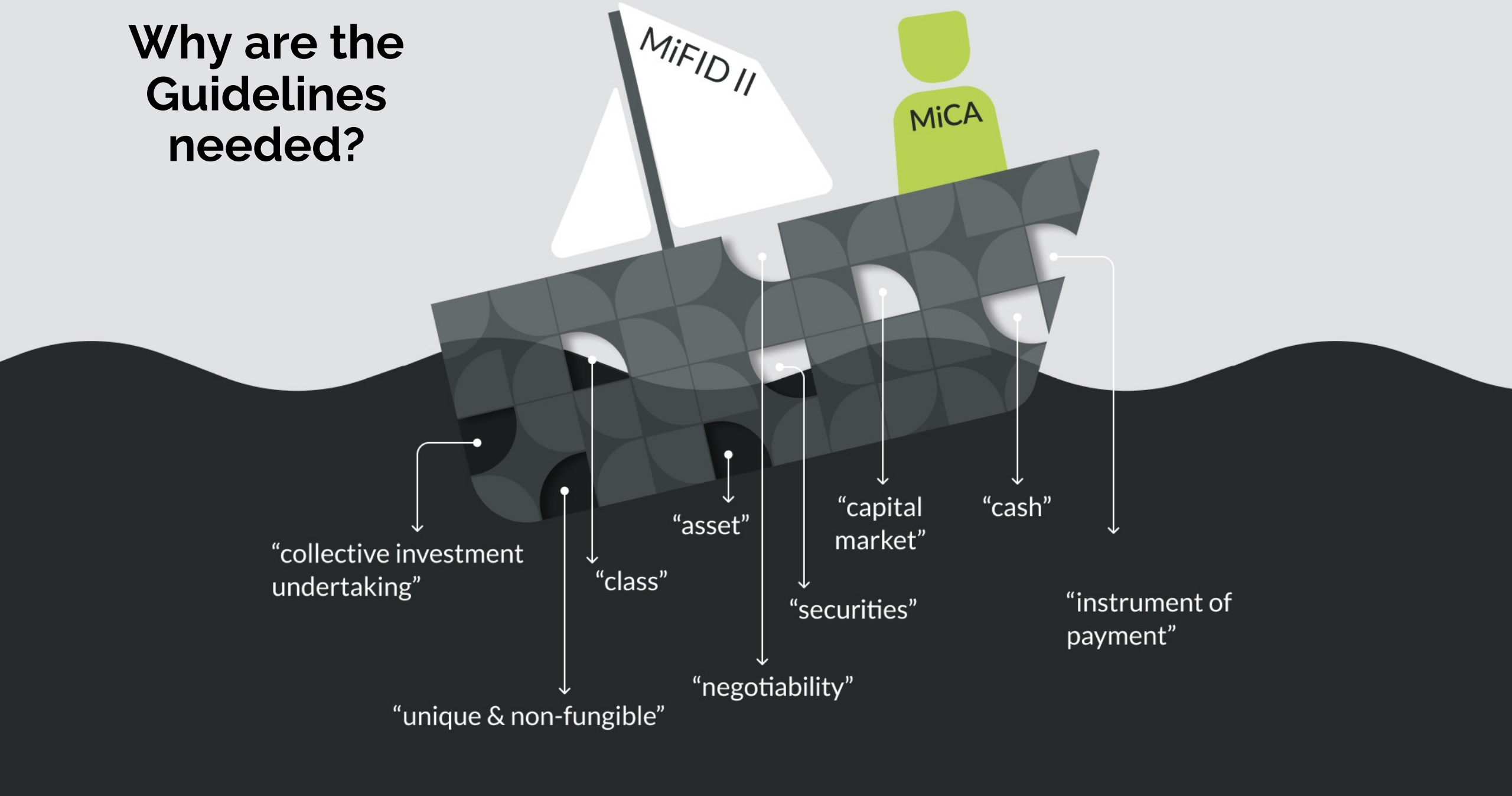
Standards and Guidelines

- European Supervisory Authorities (ESMA, EBA, EIOPA)
- To develop measures to supplement EU legislative acts:
  - Standards (legislative measures)
  - Guidelines (soft law or quasi-legislation)
- Consultation period for industry to provide feedback

ESMA’s recent consultation

- Guidelines for the qualification of crypto-assets as financial instruments
- Applies to crypto-assets other than stablecoins (ARTs, EMTs)
- Sets out to clarify whether MiFID II or MiCA applies to assets
- Promote convergent practices accross the EU

Why are the Guidelines needed?



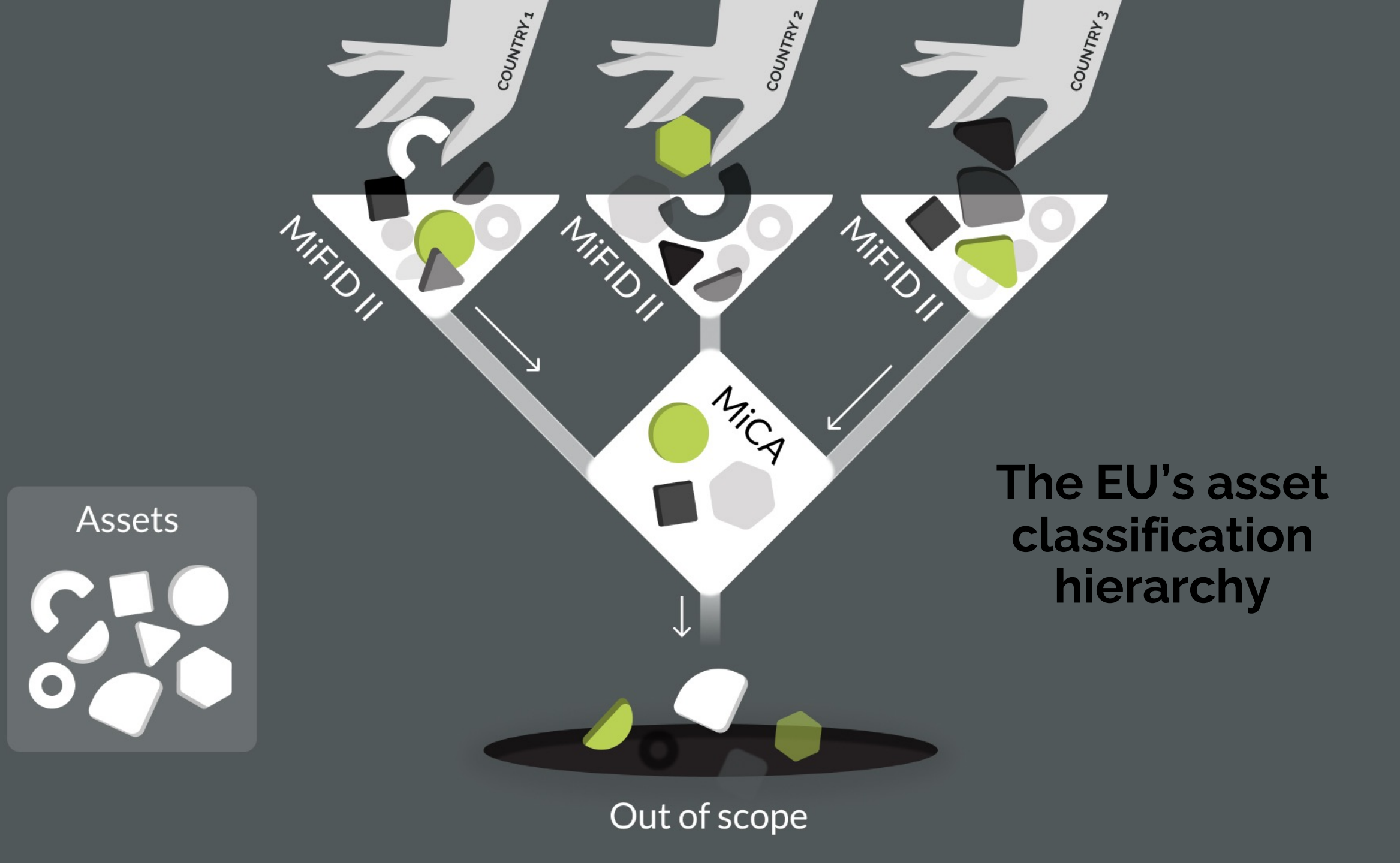
Classification of crypto-assets

- MiCA called for a standardised test
- Instead, ESMA sets out key criteria to be considered
- Guidelines clarify:
  - Features, design, rights are key factors, not technological structure
  - A case-by-case assessment is necessary
  - Substance-over form approach
  - An asset's classification may be challenged at any point

MiFID II vs MiCA

Asset-type	Applicable legislation
(a) Transferable securities	MiFID II
(b) Money-market instruments	
(c) Units in collective investment undertakings	
(d) Derivative contracts	
(e) Emission allowances	
(f) Crypto-assets[2]	MiCA
(g) Non-fungible tokens	Out of scope
(h) Hybrid crypto-assets	Depends on components

The EU's asset classification hierarchy



Crypto-assets other than ARTs, EMTs

CRITERIA

1. Transferable to other holders
2. Accepted by players other than the issuer or offeror
3. Fungible
4. Do not grant:
    - Financial rights linked to company profits, capital or liquidation surpluses
    - Voting rights in company's decision making

Key categories

Transferable securities

CRITERIA

1. Part of a class of securities
   - Interchangeable, same issuer
   - Provide access to equal rights
2. Negotiable on the capital market
   - Transferable or tradable on capital markets
   - Fungible
3. Not an instrument of payment

Challenges

- **Criteria for being part of a “class” could be easily met**
  - **In relation to rights granted**
    - Dividend vs financial rights not related to company profits/liquidation surpluses is not clearly distinguished
    - Voting in co’s decision-making vs voting on a project
- **Criteria for “negotiability on capital markets” could be easily met**
  - Terms not defined
  - DLTs facilitate transfers of ownership
  - Capable of being traded on capital markets
  - Capital raising

Derivatives contracts

CRITERIA

1. Digital representation of a contract
2. Value determined by underlying reference
3. Value changes when reference changes
4. Financial settlement

Indicator → An agreement detailing terms, maturity, price, etc.

Challenges

- Uncertainty regarding settlement using crypto-assets
- Crypto-assets don’t meet the “notion” of cash or physical assets
- Impact of future Guidelines
- Most EU CASPs may be breaching requirements if they are trading crypto derivatives

Hybrid tokens

- Assets with financial instrument and crypto-asset qualities, components and purposes
- Classification as financial instruments take precedence
- Issuers should not use marketing materials to misrepresent assets
- NCAs should not rely on labels given by issuers



Challenges

- Some use cases of crypto-assets evolve throughout their lifecycle
  - They may *morph* into a financial instrument after they are initially issued
- Practical issues
- Impact on holders
- CASPs may not want to take the risks to trade assets that may evolve into financial instruments

Other categories

Money-market instruments

CRITERIA

1. Legal & residual maturity
2. Stable value, minimum volatility
3. Aligning returns with short-term interest rates

Units in collective investment undertakings (CIS)

CRITERIA

1. Capital raised from token holders (investors)
   - Pooled to be invested
   - To generate a pooled return
2. Issuer (CIS) has no commercial or industrial purpose
3. Token holders (investors) do not exercise day-to-day control
4. Crypto-assets (units) managed by CIS manager
   - In accordance with an investment policy

Emission allowances

CRITERIA

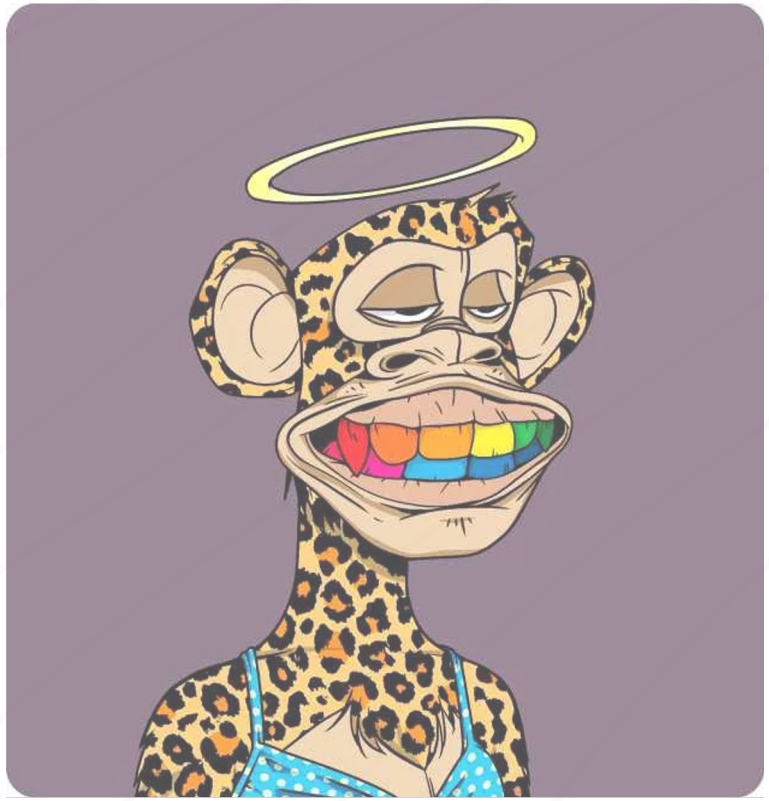
1. Represent a right to emit a specified volume of greenhouse gases
2. Tradable
3. Comply with the EU Emissions Trading Scheme or equivalent
4. Endorsed by the EU/MSs
5. Symbolise approved units



Non-fungible tokens (NFTs)

CRITERIA

1. Unique characteristics, not interchangeable
2. Value must be linked to individual characteristics & utility
3. Value is not influenced by the value of other assets (i.e. not part of a collection)



What's next?

Key impact on market

- Challenges for regulators
  - May prefer categorising assets as financial instruments
- Challenges for ESAs
  - Providing opinions to NCAs in a short period of time
- Challenges for market participants
  - Passporting of activities if financial instruments are categorised differently by different NCAs
  - Should firms seek a MiCA or MiFID II authorisation?

Next steps and conclusion

- Respond to consultation by 29 April 2024
- MiFID II updates?
  - Definition of financial instruments
- Joint Guidelines on the qualification of ARTs → expected later this year
- Fundamental questions remain unanswered!



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Questions?

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