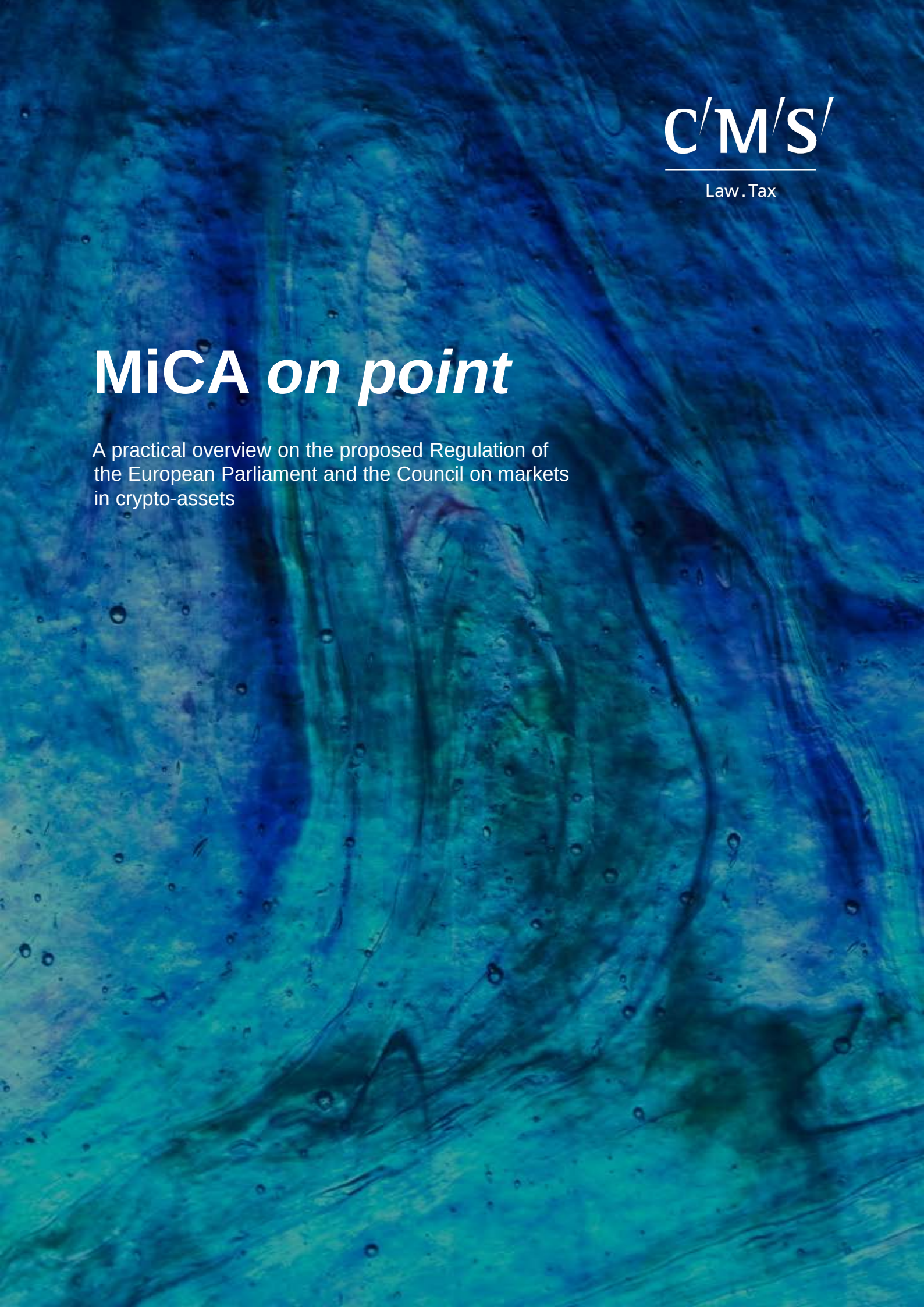

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MiCA *on point*

A practical overview on the proposed Regulation of the European Parliament and the Council on markets in crypto-assets

Foreword

In addition to providing legal advice, CMS carefully monitors the latest developments in the market and shapes them through its involvement in advisory legislative committees. In this way, we keep up to date on which legislative initiatives are being discussed and where future priorities lie, which also allows us to identify new trends.

Such a new focus is currently becoming increasingly apparent for credit institutions, financial and payment service providers, but also for start-ups or funds due to the ongoing digitalisation and against the background of current legislative projects at national and European level. The supervisory framework for crypto-assets will, in the foreseeable future, be a key part of the day-to-day business of many companies with roots in the financial sector. For this reason, the brochure "MiCA on point" is intended to provide an initial overview of the proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets presented by the European Commission on 24 September 2020, thus providing an easier introduction to the topic.

We would be glad to offer individual workshops and webinars for employees from different departments, in which we examine practical questions from your perspective. Please let us know if you require further information in addition to our offer, or if you would like to delve into greater detail on a certain topic. We would be pleased to discuss further details with you on the telephone or in person. We look forward to hearing from you.

With kind regards,

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Introduction

The EU's regulatory aspirations

At the end of September 2020, the European Commission published its digital finance strategy, which, in addition to regulations for blockchain sandboxes, contains in particular a proposed regulation for crypto-assets. With this "Regulation on Markets in Crypto-Assets" ("MiCA"), the Commission is seeking to strike a balance between fostering innovation and regulation. When drafting MiCA, the EU legislator saw one of the main problems in the field of crypto-assets as being the lack of European harmonisation. Germany, for example, adopted rules on crypto-asset custody at the beginning of the year, but other Member States have yet to adopt such rules. This lack of harmonisation is currently hampering the emergence of a single European market in the field of crypto-assets. This makes it difficult to build a strong market as a counterweight to the USA and Asia. The European Commission is now responding by presenting this proposed Regulation. The aim is to create legal certainty, boost consumer/investor protection and market integrity and increase the financial stability of crypto-assets.

The technology behind crypto-assets

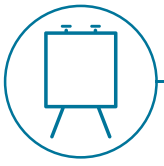
MiCA will create a comprehensive regulatory framework for four types of crypto-assets (also known as tokens). The term crypto-asset stems from what is known as distributed ledger technology ("**DLT**"). In simple terms, this can be described as a decentralised, digital ledger with shared read- and write-access rights for participants. Unlike a centrally administered database, this network does not require a central instance to make new entries in the database. Participants themselves are able to add new datasets at any time. A subsequent update process ensures that all participants always have the latest version of the database. As with most regulations, however, MiCA is open to new technologies and thus also regulates other similar technologies, with the emphasis on the distributed storage of encrypted data. Blockchains are the main use case for this. It is important to familiarise oneself at an early stage with the technology behind individual products and the associated legal consequences to be able to ensure legal certainty.

Implications for existing business models

The EU has recognised the significance of crypto currencies after Ms. von der Leyen's wake-up call. The public consultation on an EU framework for crypto-assets launched by the Commission closed in March 2020 with 197 submissions. This shows that the European Union is not wrong in its assessment. There is considerable public interest in the regulation of crypto-assets, as digitalisation gradually also takes hold in the financial world. Although MiCA is not yet applicable, companies concerned should already comply with its rules to avoid having to amend issued tokens or to prepare for authorisation procedures. Early communication with the competent supervisory authority is also important and expedient to avoid regulatory conflicts. In addition, the legislator wishes to create a large number of thresholds and sandboxes that will allow small and innovative projects in particular to develop. It is therefore important to stress that both the regulatory implications for existing business models should be examined early on and that planned projects should be developed now to avoid additional costs in light of MiCA.

The status of the legislative procedure

MiCA is intended to ensure the uniform treatment of crypto-assets throughout the EU's Member States. The legislative process is currently in its infancy. The Commission's proposed regulation is a legislative initiative to be adopted jointly by the European Parliament and the Council of Ministers in the coming months. It is anticipated that (an estimated) two more years will elapse before the standards enter into force. It should also be kept in mind that changes to the content of the previous draft can be made during this time frame. This brochure is intended to provide an overview of the proposed Regulation as it stood when it was published on 24 September 2020. We would be happy to inform you about rules that go beyond or deviate from the proposal.



Executive summary

The core of the Regulation: The qualified prohibition

The proposed Regulation focuses on creating the framework for the future supervision of issuers and crypto-asset service providers by national authorities or the EBA. The law distinguishes between different types of crypto-asset and links a large number of legal consequences – which are quite far-reaching in detail – to this classification. Measures range from harmonised minimum disclosure requirements for issuers in the form of "white papers" to a qualified prohibition on operating in the crypto-asset business. The much discussed ban on stablecoins is thus no longer on the table. The Commission has decided that this business model is admissible in principle, but is applying tight regulatory safeguards.

A new-old supervisory authority

Under the MiCA regime, issuers of "significant tokens" may become subject to the supervision of the European Banking Authority ("**EBA**") if the thresholds defined in MiCA are exceeded. The legislator is thus reacting to the push by global big tech companies to revolutionise the payment market by issuing a privately created crypto currency. The EU is thereby seeking to create a third supervisory body alongside national supervisors and the ECB. Until now, the EBA (mainly) had the task of improving the functioning of the Internal Market by working towards harmonised supervision and regulation at the European level, but it was not a supervisory authority in the strict sense.

Old liability risks in a new context

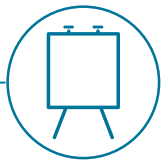
MiCA also has a further focus on regulating the scope of liability of crypto-asset issuers. On the one hand, the legislator resorts to the national supervisory authorities and assigns them a comprehensive catalogue of powers of intervention in Article 82 MiCA. These range from veto rights on the publication of a white paper to the name-and-shame powers already available under supervisory law, to the power to prohibit business operations. On the other hand, the foundations are being laid for new claims which, from a doctrinal standpoint, are closer to the prospectus requirements. For example, under Articles 14, 22 and 47 MiCA, both the issuer and the issuer's directors are liable for errors in the white paper.

A new form of duty to publish a prospectus?

The Regulation sets out in detail the minimum requirements for the white papers already mentioned. These are key because MiCA only permits public offerings of crypto-assets or their admission to a trading platform if such a white paper has been prepared and published in compliance with the new requirements and the supervisory authority has expressed no objection. The authorities may prohibit the issuer from operating on the market if the white paper or the issuer fail to comply with MiCA requirements. These requirements concern in particular the description of the respective crypto-assets and their risk factors, including risks related to the respective tokens' fungibility. The exemptions provided for in MiCA in this context largely reflect the exemptions already existing in prospectus legislation.

The new definitions of crypto-assets

In addition to "general" crypto-assets, MiCA will in future provide a detailed regulatory framework for asset-referenced tokens and e-money tokens. The general section of the Regulation includes a whole series of definitions at Article 3 (1) MiCA. These are to a large extent newly created legal concepts that are very much open to interpretation. As such, it remains to be seen how the supervisory authorities will position themselves on the proposed Regulation. However, there are also references to definitions already known from supervisory law, such as the reference to Regulation EU/575/2013 ("**CRR**") on the definition of a credit institution the distinction between crypto-assets and financial instruments by reference to Directive EU/2014/65 ("**MiFID II**"). The latter is also due to be amended in the course of the legislative process to avoid any legal conflicts between MiFID II and MiCA.



MiCA methodology

Initial overview and introduction to MiCA

MiCA's structure and style are typical of EU regulations. It is divided into nine titles in total, which in turn are divided into individual chapters.

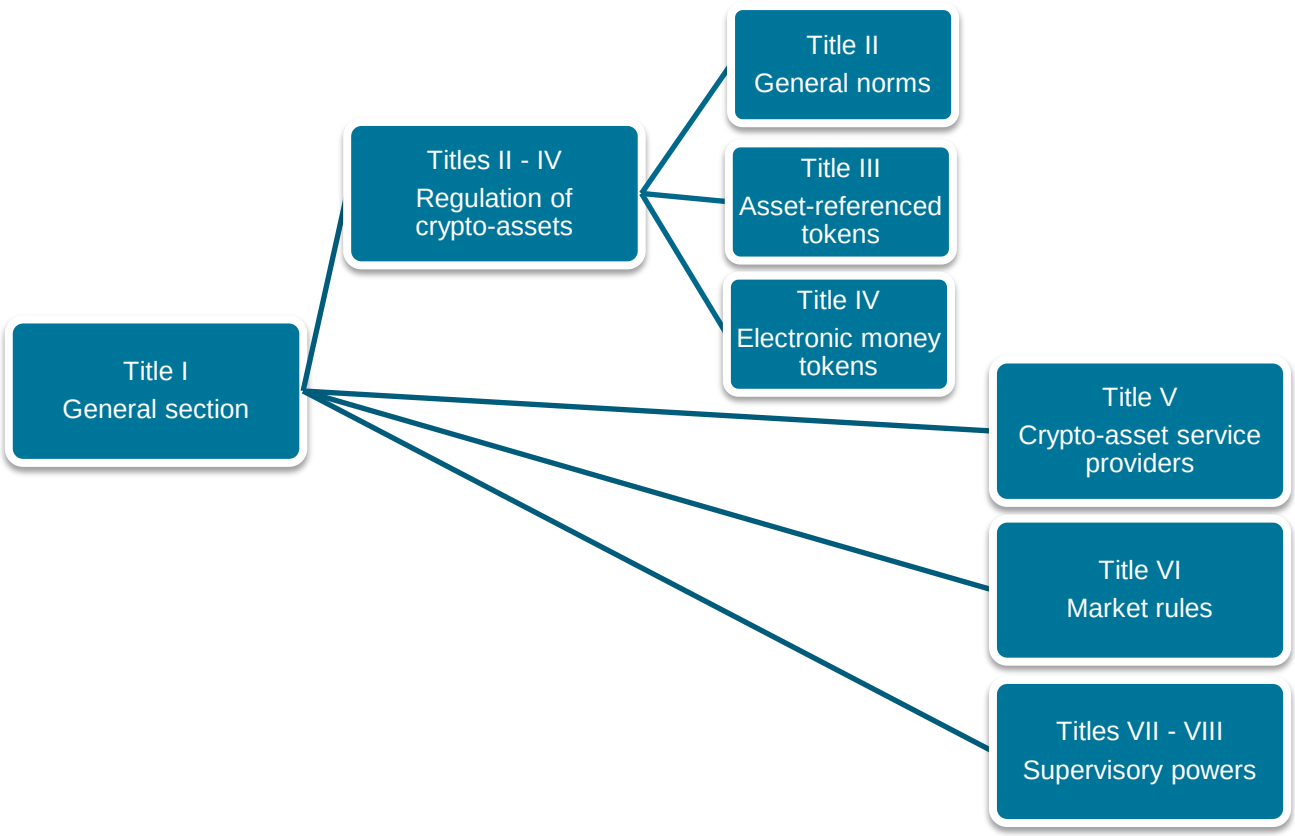
As such, MiCA's structure quickly becomes clear from a brief overview of its content. The legislator creates a framework by opening with a general section at Title I, which applies to the Regulation as a whole. It defines the scope of the Regulation and the applicable definitions.

In the following Titles II - IV, the legislator then lays down the regulatory requirements for crypto-assets. It begins with "crypto-assets other than asset-referenced tokens and e-money tokens." The Title II norms are then repeatedly referred to throughout the following specific rules, thereby creating a kind of second general section.

Title V MiCA governs the supervision-law requirements for crypto-asset service providers, followed by the provisions of Title VI to prevent market abuse.

Finally, Titles VII and VIII address the powers of supervisory authorities. The powers of national supervisory authorities, in Germany the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – "*BaFin*"), and of the EBA are set out in detailed provisions. Title IX follows, including the transitional and final provisions.

In simplified terms, MiCA's regulatory methodology can therefore be illustrated as follows:



Scope of MiCA

Crypto-asset definitions in MiCA

It is safe to assume that the concept of crypto-assets and their specific variants will frequently dominate future application of the law. In this respect, there are parallels with MiFID II or the German Banking Act (*Kreditwesengesetz – KWG*) in the regulatory approach chosen by the legislator. In the case of a financial instrument or, in MiCA terminology, a crypto-asset, MiCA applies and the consequences under supervisory law must be examined.

The proposed Regulation defines crypto-assets in Article 3 (1) (2) MiCA as a:

"a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology."

This very broad legal definition creates an umbrella term that covers all types of digital assets.
Article 1 (1) nos 3 - 4 MiCA then provides further legal definitions of "asset-referenced tokens" and "e-money tokens". These are subject to specific requirements under MiCA in its Titles III-IV. If the product does not meet any of these specific requirements, then the general MiCA provisions apply. These products are therefore referred to in the following as "general crypto-assets". A precise legal categorisation of the product and the technology used by the product is necessary to determine beyond doubt the requirements under MiCA that are applicable to the issuer and the product itself.

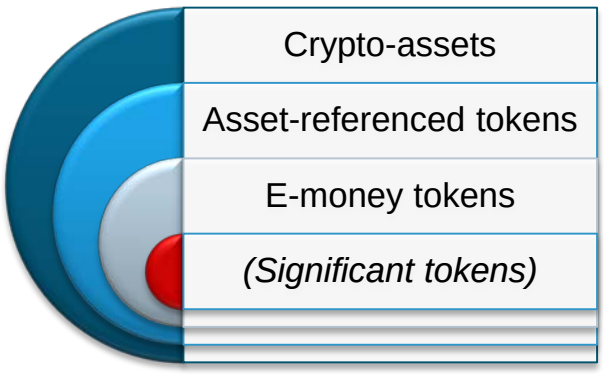
If the product is categorised as an "asset-referenced token" or "e-money token", it still needs to be checked whether it qualifies as a so-called "significant crypto-asset". This is not an independent asset class, but refers to special forms of asset-referenced and e-money tokens which, in the legislator's view, require special supervision by the EBA due to their economic significance in legal transactions. To this end, Article 39 MiCA (for asset-referenced tokens) and Article 50 MiCA (for e-money tokens) lay down specific criteria for determining whether compliance with the requirements for significant crypto-assets is mandatory. Examples of these new criteria are the size of the customer base or the number and value of transactions processed. In future, the EBA will also be responsible for deciding whether these criteria are met.

Exemptions

The Regulation is not intended to be applicable to certain organisations despite the existence of crypto-assets. To this end, Article 2 MiCA defines exemptions from its scope that are consistent in their regulatory approach with already existing supervisory laws.

The initial focus will be on the exemptions for credit, financial services and payment institutions, to which individual MiCA rules will not apply. In principle, however, these institutions must comply with the Regulation.

Under Article 2 (3) (d), MiCA is also not applicable where crypto services are provided only to group companies. At this point, the Regulation uses the term "parent companies" without further definition. It remains to be seen whether and, if so, how the legislator will define the relevant circle of companies to be included. It is conceivable that the CRR definitions might be used.



Standards for general crypto-assets

Law of the place of performance under the MiCA regime?

The European General Data Protection Regulation ("**GDPR**") applies as soon as data is processed relating to persons located in the EU. This also applies even if the data are processed by a controller not established in the European Union. This is known as the law of the place of performance. It means that while foreign companies may process data, they must comply with GDPR requirements on entering the EU marketplace.

The legislator refrained in part from implementing a similar system in its MiCA regulations, even though this might well have been a possibility in view of the products' digital design. In order to be allowed to operate in the EU, for example, issuers of asset-referenced tokens pursuant to Article 15 (2) MiCA must be incorporated in the form of a legal entity established in the EU.

However, there is no comparable rule for general crypto-assets, so that a kind of place-of-performance principle does apply to them. Issuers of such assets must act in the legal form of a legal entity, prepare a white paper on the product and submit it to BaFin. If the authority raises no objections, general crypto-assets may be offered to the public under the MiCA regime.

White paper requirements

Content and form of the white paper are set out in Article 5 MiCA. By introducing the associated publication requirement, the legislator's intention is to create transparency for the market and customers. The white paper must describe the key features of the crypto-asset and its associated risks. You will find an overview of the main points that need to be published under the MiCA regime in the CMS Checklist. There are also exemptions, however, for example for crypto-assets offered for free, or where the total consideration of the offering of crypto-assets is less than EUR 1,000,000 over a period of 12 months.

It should be expressly noted that Articles 14, 22 and 47 MiCA establish liability for incomplete or misleading information published in the white paper. Any customer that suffers a loss as a result can in future claim compensation from both the issuer and its management.

CMS-Checklist

What must the white paper essentially include?

- a detailed description of the issuer;
- a detailed description of the type of crypto-asset;
- the reasons why the crypto-assets will be offered to the public;
- a detailed description of the characteristics of the offer to the public;
- the number of crypto-assets that will be issued;
- the issue price of the crypto-assets;
- the subscription terms and conditions of the crypto-assets;
- a detailed description of the customer's rights and obligations;
- a description of the underlying technology behind the crypto-asset;
- a description of the method for holding, storing and transferring the crypto-assets;
- a detailed description of the risks relating to the issuer of the crypto-assets and the assets themselves;
- a statement that the crypto-assets may lose their value in part or in full and
- a statement that the crypto-assets may not be liquid.

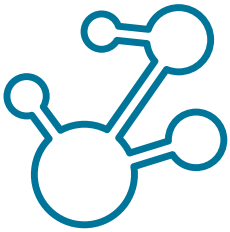
Special requirements for asset-referenced tokens

Prohibition with reservation on consent

In future, there will be strict rules governing the issuance of asset-referenced tokens. Asset-referenced tokens are defined in Article 3 (1) no 3 MiCA as assets that replicates a stable value by reference to fiat currencies, goods or other crypto-assets. These will therefore mainly include so-called "stablecoins". The classic function of a stablecoin is primarily to enable a crypto-asset (such as Bitcoin) to be quickly exchanged for a traditional asset (such as gold) without having to leave the relevant trading platform.

The white paper requirements are applicable, as are the provisions of Articles 15 ff. MiCA. In future, the issuance of asset-referenced tokens will generally be subject to a qualified prohibition. Credit institutions will be exempted from the authorisation requirement, however. The commencement of business will require the completion of an authorisation procedure with BaFin comparable in nature and scope to the German Banking Act (*KWG*). For example, Article 16 MiCA sets out the requirements for the application for authorisation. These come very close to the requirements of section 32 (1) sentence 2 German Banking Act. However, an issued permit should then be valid throughout the European Union. The MiCA therefore also provides for a passporting system.

MiCA completes the above requirements in terms of legal consequences. It creates powers of intervention for the supervisory authorities in the event of a legal infringement and sets out the conditions for withdrawing or refusing an authorisation.



Requirements for issuers

Issuers of asset-referenced tokens also face behavioural and capital requirements under the MiCA regime.

According to Article 31 MiCA, for example, they must at all times have own funds of at least EUR 350,000 or 2% of the newly created "reserve assets" pursuant to Article 32 MiCA. The higher of the two values must be observed.

In addition, Articles 23 ff. MiCA establish disclosure obligations, the duty to inform clients, or rules on conflicts of interest which issuers must comply with at all times.

These new rules are substantial and require a case-by-case examination for each product or issuer. For example, individualised policies must be drawn up for the issuer, or the requisite own funds pursuant to Articles 31 ff. MiCA must be calculated according to the circumstances in each case.

Finally, it is worth reiterating that if an asset-referenced token qualifies as a "significant crypto-asset", this triggers EBA supervision of the issuer (further information on page 7).

Special requirements for e-money tokens

Qualified prohibition

The issuance of e-money tokens, meaning crypto-assets that are used as a stable-value medium of exchange and are based on the value of a fiat currency, will also be strictly regulated in future.

Issuing an e-money-token or asset-referenced token will require permission from BaFin. Article 43 MiCA provides that e-money tokens may in principle only be issued if the issuer is authorised as a credit institution or as an electronic money institution and provided that certain requirements under Directive 2009/110/EC ("**E-Money Directive**") are observed. The reference to the E-Money Directive means, for example, that granting interest is prohibited under Article 43 (1) (a) in conjunction with Article 12 E-Money-Directive.

However, for the issuance of e-money tokens, the legislator has also created exceptions to the requirements just described. The requirements of Articles 43 ff. MiCA do not apply, for example, if the e-money tokens are only distributed to professional investors and can only be held by such investors, or if the amount of e-money tokens issued does not exceed EUR 5,000,000 over a period of 12 months. The definition of so-called "qualified investors" can be found in Article 2 (e) of Regulation (EU) 2017/1129 (known as the Prospectus Regulation).

These two examples alone show that the mandated applicability of different regulatory regimes for the issuance of e-money tokens leads to complex supervision-law requirements characterised by a multitude of applicable statutory provisions. It is therefore advisable to establish at an early stage which regulations will apply to existing or planned products to avoid regulatory complications. This is all the more important given the requirements imposed on issuers.

Requirements for issuers

In contrast to the regulations for asset-referenced tokens, MiCA does not standardise extensive and new capital or conduct requirements with regard to e-money tokens. While Articles 43 ff. do include compliance requirements for issuers, these mostly just modify provisions of the general part of MiCA for the specific e-money tokens. For example, Article 46 MiCA sets out different requirements for the content of the white paper.

The reason for this absence of new rules is the requirement that e-money tokens may in principle only be issued if the issuer is authorised as a credit or e-money institution. In this way, the legislator has ensured that (as understood at national level) the authorisation requirements as set out in section 32 German Banking Act or section 10 German Payment Services Supervision Act (Zahlungsdiensteaufsichts-gesetz – ZAG) have been met from the outset. For example, the application for authorisation to operate a credit institution must include suitable evidence of the resources needed for business operations. Here, the legislator has drawn on already existing structures under supervisory law, linking them to the newly created MiCA requirements.

New rules for crypto-asset service providers

Definition of crypto-asset business

In addition to the new regulation on crypto-assets and their issuance described above, services and activities in connection with crypto-assets will also be subject to state supervision in future. To this end,
Article 3 (1) no 9 MiCA defines "crypto-asset services". This includes:

- 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 fiat currency that is legal tender;
- the execution of orders for crypto-assets on behalf of third parties;
- placing of crypto-assets;
- the reception and transmission of orders for crypto-assets on behalf of third parties;
- providing advice on crypto-assets.

A new-old supervisory law

The provision of crypto-asset services will in future also be subject to authorisation and is largely regulated under supervisory law. As such, the regime envisaged by MiCA fits into and is largely similar to the existing supervisory structures.

Article 57 MiCA provides for the European Securities and Markets Authority ("**ESMA**") to establish a register of all crypto-asset services providers. It is not yet clear from the proposed Regulation why the legislator is involving a further authority in addition to the national authorities and EBA. It remains to be seen whether this proposal will be implemented in its current form.

Articles 60 ff. set out capital requirements for crypto-asset service providers and extend the fit and proper managers test, already established under national supervisory law, to the MiCA regime. Crypto-asset service providers must also meet organisational requirements and submit reports to the competent authorities.

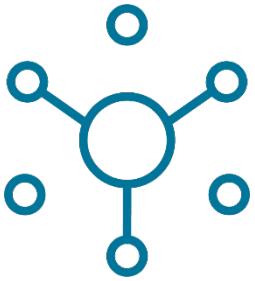
All this shows that existing supervisory structures have been built upon and can be built upon by market participants.

Implications for supervisory law

The regulations created by the legislator provide a clear regulatory framework for the operation of the crypto-asset business. However, it should be clear to precisely those companies that were previously subject to regulation that these requirements become relevant in a variety of situations. It is often the case that supervisory law already places considerable compliance demands on companies when it comes to structuring measures under corporate law, internal modernisation measures or even merely the purchase of services from third parties.

For example, detailed regulations on outsourcing are also implemented in MiCA. For example, if a crypto service provider wishes to use an external cloud service, rent a server or use other external services, this is generally already deemed an outsourcing use case.

As a general rule: To avoid unpleasant surprises when it comes to regulatory requirements, any planned measure must undergo a thorough case-by-case review (well) in advance of its implementation. This is the only way to prevent a legal infringement that might lead to BaFin action, fines against the company and its managers personally or, in the worst case, even the initiation of criminal proceedings.



Final remarks

The death of entrepreneurial freedom or a blessing?

The draft MiCA submitted by the European Commission on 24 September 2020 includes far-reaching new rules. The trend in recent years towards more, not less, regulation in the financial sector continues. Time and again, companies are forced to keep up to date with the regulatory framework applicable to them. They can now add MiCA to that list.

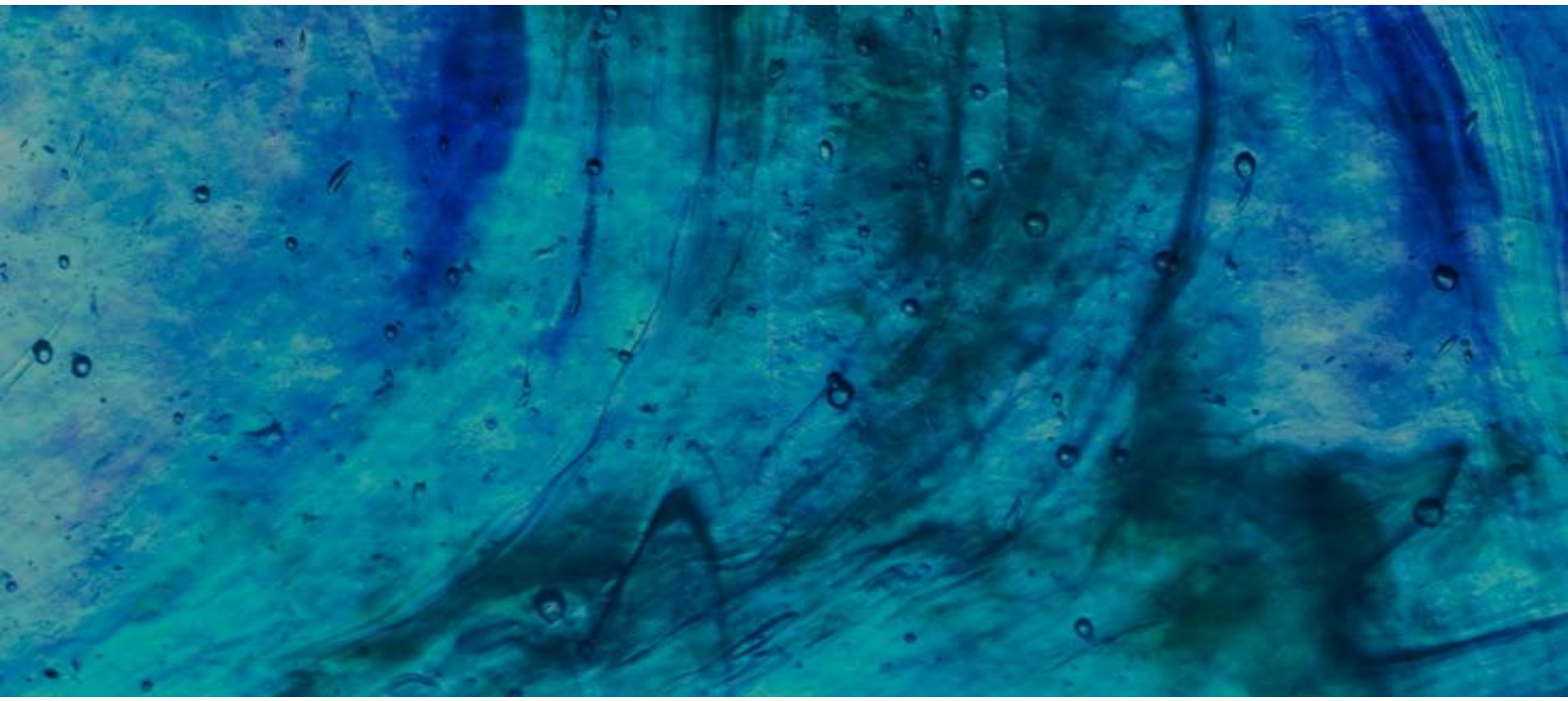
It is natural that new regulations are often seen as significant legislative infringement of entrepreneurial freedom. However, this should not be viewed solely in a negative light by those concerned. It is worth noting that state regulation can also be put to positive use. State supervision can give customers a sense of security and guarantees all parties to a transaction greater certainty in their day-to-day business.

We will be happy to assist you with any MiCA-related challenges arising in the coming months. As always: keep up-to-date and use the new rules to your advantage.

Conclusion

As it stands, MiCA already provides a single regulatory framework for the crypto market. Many regulations fit seamlessly into pre-existing supervisory law, tie in with it or are very similar in their regulatory structure. While the proposed MiCA does contain a few legal uncertainties, it should be noted that the regulatory process is not yet complete. By the time the final version of MiCA is adopted, the legislator can and will certainly remove those uncertainties.

In future, entrepreneurs and customers in the crypto-market will find a framework that increases legal certainty overall.



Your notes