European Crypto Initiative

European Crypto Initiative - May 13, 2022

Technical position on MiCA - Trilogues

The European Crypto Initiative appreciates the opportunity to share comments and suggestions as MiCA negotiations progress to their conclusion. Our comments are in line with previous remarks made since the Commission issued its proposal and are targeted at ensuring the future viability of crypto-related activities in Europe. We do support some of the recent developments in the negotiation process, notably the numerous efforts made towards clarification of the scope, sustainability issues, proportionality and practicality of the obligations set forth by the regulation. Nonetheless, given the direction of travel on certain key aspects summarised below, we fear that the message the European Union could send to entrepreneurs and user-governed platforms is that they might want to reconsider doing business in Europe - especially at a time where global standard setters are calling for a consistent approach to what is a truly global phenomenon.

This document provides an overview of the most pressing concerns identified.

I. Scope

Since the Commission's first draft, the focus of amendments has been on clarifying and narrowing the scope, but, unfortunately, the amendments proposed had the opposite effect in particular cases. As an example, the topics that have specifically been left out of the scope of MiCA now come with a particular level of uncertainty. While some of the Recitals stipulate the exclusion of **DeFi**-applications or **NFT**s (i.e. *EP Rc 8a, 13, 13a*), the regulation does not formulate this exclusion in a reliable, clear, and unambiguous manner in its existing articles.

Other amendments have expanded the scope broadly. As an example, the scope of the regulation was limited to "*persons that are engaged in the issuance of crypto-assets or provide services related to crypto-assets in the EU*" (*Art. 2 of the European Commission's proposal*). However, this scope was expanded to natural persons and finally to **undertakings that are involved in the listed activities**, covering previously unmentioned entities.

In this regard, we are worried that the Council's version of **Article 2, namely point 1** is very broad and, as we understand it, could be interpreted as bringing Decentralised Autonomous Organisations (DAOs) within the scope of MICA.

Those issues bring **legal uncertainty** and may prevent one of the main goals of MiCA: legal clarity for the industry and consumers. This concerns more specifically DeFi (I.1) and NFTs (I.2).

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I.1. On Non-fungible tokens (NFTs)

In the European Parliament's draft, the **"exclusion" of NFTs is narrowed** (*Rc 8a, Art.4(2)c*) and only excludes them from the scope if they are not considered financial instruments, not fractionable, not transferable without the issuer's permission or not admitted to trading on a crypto-asset exchange.

As a crypto-asset is **easily fractionable** and by default **transferable without the issuer's permission** and can be freely listed on open exchanges platforms, **most NFTs will be within the scope** of the EP-draft addition in *Art.4(2)c*. This is inconsistent with the current NFT use cases, which are mostly digital collectables and various representations of unique digital goods (e.g. domain names, tickets, digital identities). Our strong belief is that all of these use cases differ significantly from the crypto-assets, which are at the core of the proposal for MiCA and therefore call for **NFTs' ad-hoc regulation.**

In addition, we understand that in the most recent discussions consideration is being given to only exempt NFT issuers from drafting a whitepaper but apply all the other requirements to them and CASPs providing NFT services. We share the concern of some Member States that this significantly widens the scope of the regulation as well as hinders the growth of this sector.

As a conclusion, we call for the **meaningful exclusion** of NFTs from the scope of MiCA to the most extent possible as proposed by the *Council in Article 2.2a* explicitly. *EP-Draft Rc 8a and 8b* by the EP are not sufficiently effective in this regard, especially when coupled with *Article 4(2)c* from the EP-Draft Rc.

Should the Trilogues favour the option for Recital 8, its scope should be amended as follows:
"The crypto-assets are unique and not fungible with other crypto-assets~~, or~~ **and** are not ***fractionated*** ~~or are not fractionable and not transferable directly to other holders without the issuer's permission, or are accepted only by the issuer, including merchant's loyalty schemes, or represent IP rights or guarantees, or certify authenticity of a unique physical asset, or any other right not linked to the ones that financial instrument bear,~~ and are not admitted to trading on a crypto assets exchange.""

As a further recommendation, NFT supervision should be included as part of the review framework that the Regulation caters for in Art. 122 so as to ensure ongoing monitoring of developments in these areas, with the possibility for the Commission to adapt the MiCA framework to those evolving use cases in the future if appropriate.

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I.2. On Decentralised Finance (DeFi)

With the explicit recognition of DAOs and some relaxed obligations (*Art. 4 3b*) the EP-draft seems slightly more favourable towards decentralised and user-governed platforms but falls short of protecting innovation as it sets out **obligations that are, for a large part, not workable for real decentralised systems**. Moreover, as also mentioned in **point I** above, there is the risk that the scope of MiCA is set too broadly and would unnecessarily cover DAOs.

In addition, *Art.4(1)* suggested by the EP creates an **authorisation requirement for all crypto-assets** without specifying the procedure. This will create high uncertainty and makes the whitepaper based process cumbersome and impractical. Furthermore, as DeFi is not included or explicitly excluded in the Regulation, this authorisation requirement will make it **impossible for decentralised, user-governed projects to be compliant in Europe**.

Therefore, we call for the **explicit exclusion of DeFi from the scope of MiCA**. For this purpose, Recital 12a of the Council provides with a very good initial drafting, that we suggest amending for clarification as below:

This Regulation applies to natural and legal persons and the activities and services performed, provided or controlled in any manner, directly or indirectly, by them, including when part of such activity or services is performed in a decentralised way. ***This Regulation does not apply to natural and legal persons that do not exercise control on a decentralised product or service.*** *This Regulation covers the rights and obligations applicable to issuers, offerors and persons seeking admission to trading of crypto-assets and to crypto-asset service providers. Where crypto-assets have no offeror and are not traded in trading platform which is considered to be operated by a service provider the provisions of ~~Title II~~* ***this Regulation*** *do not apply. Crypto-asset services provided for such crypto-assets ~~should be~~* ***are*** *subject to this Regulation. Nevertheless, when those crypto-assets are offered by a person or traded in a crypto-assets trading platform the requirements of this Regulation apply to that person and to that crypto-assets trading platform.*

As those use cases should not be left unsupervised, DeFi supervision should also be included as part of the review framework that the Regulation caters for in Art. 122 - so as to ensure ongoing monitoring of developments in these areas, with the possibility for the Commission to adapt the MiCA framework to those evolving use cases in the future, if appropriate.

II. On Asset-referenced tokens and E-Money Tokens significance thresholds

According to the EPs Draft, ARTs and EMTs need to fulfil **three** of the criteria set out in the regulation to be deemed significant. The requirement *interconnects with the financial system* and the *significance of cross-border activities* are both separate criteria leading to almost **every ART or EMT fulfilling these two by default**. In addition, EP suggests a new criterion: the issuer being a gatekeeper according to the DMA (Art.39 (1) da).

We consider these criteria and thresholds not to appropriately reflect the market volumes, as currently, there isn't a stablecoin in actual use that does not exceed the threshold of EUR 5 mln (e.g., USDT, TUSD, USDC, USDS, EURS, DAI). Therefore, **keeping such a low threshold would make the segmentation between significant and insignificant ARTs/EMTs pointless**.

We therefore call for the adoption of the highest thresholds possible - as proposed by the Commission - although we consider them too low.

III. Transitional measures - Application date

We support the Council when calling for a longer transition period and think that 24 months are the minimum requirement for a smooth transition and will prevent the overburdening of European entrepreneurs. Businesses need to have enough time to **implement the extensive list of obligations**. They will probably have to seek **additional funding to comply with the capital requirements** and go through **lengthy authorisation processes**.

The European Agencies also **need time** to implement procedures, develop the standards, and organise new capacities required for the numerous new tasks. If the European Council calls for a longer period while the Member States will carry the most significant load of implementation, we recommend following its recommendation.

We recommend adopting a 24-month transition period as per Council proposal.

IV. Sustainability concerns

MiCA is a **regulation of market participants,** and therefore, rules on **sustainability and energy consumption are somewhat misplaced** in this regulation. We however support the call to include the crypto-asset market and the broader financial market in the **EU sustainable finance taxonomy at the next possible point in time** and, therefore, generally support the Parliament's suggestion of *Art.2a*.

While generally supporting, we call for caution when setting a specific date. The EU does not play a significant role in crypto-mining at this point in time. A rushed regulation might **solidify the irrelevance of the EU** when it comes to verifying these share-databases **increase dependence on foreign actors**.

Moreover, the proposed sustainability-related provisions create a tremendous administrative burden for companies, coupled with many practical issues. For example, the way CASPs are going to be able to obtain the necessary information, such as sustainability indicators and the climate-related impact of all the crypto assets on their platform, and then publicly share it on their websites, is unclear. Therefore, there's a need to find the right balance between the collected and shared information and the precise effort that can realistically be expected from companies, especially when it comes to SMEs.

We therefore suggest that **Article 5(1), points (bb) and (bc), as well as Article 59(4a),** are removed from the final version of MiCA.