

FINANCIAL REGULATION

Digital finance update:
*provisional agreement reached
on MiCA and transparency of
crypto-asset transfers*

On 29 June 2022, the Council presidency and the European Parliament reached a provisional agreement on recasting the Regulation on information accompanying transfers of funds (Regulation (EU) 2015/847) (**Funds Transfer Regulation or FTR**).

The key feature of this agreement is that the 'travel rule', which requires information on the parties to the transaction to be collected and transmitted throughout the transaction chain, is extended to transfers of crypto-assets.

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On 30 June 2022, the Council presidency and the European Parliament also reached a provisional agreement on the market in crypto-assets regulation (**MiCA**). MiCA brings crypto-assets, crypto-asset issuers and crypto-asset service providers under a regulatory framework at European Union (EU) level for the first time, and aims to put an end to, what some law-makers have described as, “the crypto wild west”.

Below we set out key features of these provisional agreements, which crypto-asset issuers and crypto-asset service providers (CASPs) should factor into their horizon scanning and compliance risk frameworks. In particular, CASPs should be aware of the proposed authorisation requirement in order to operate in the EU.

Background

The provisional agreement in respect of the FTR is part of a package of legislative proposals to strengthen the EU’s anti-money laundering and countering terrorist financing (**AML/CFT**) rules, presented by the Commission on 20 July 2021. This package also includes a proposal to create a new EU authority to fight money laundering.

The MiCA provisional agreement is part of the larger digital finance package presented by the Commission on 24 September 2020, which is aimed at developing a European approach that fosters technological development and ensures financial stability and consumer protection. In addition to MiCA, the package contains a digital finance strategy, a Digital Operational Resilience Act (**DORA**) and a proposal on distributed ledger technology (**DLT**) regime for wholesale uses. Significant progress has been made in respect of these aspects of the digital finance package, with political agreement reached in respect of DORA on 11 May 2022, and its formal adoption by the European Parliament scheduled for October 2022. The DLT Regulation came into force on 22 June 2022, with the majority of its provisions set to apply in EU member states from 23 March 2023.

Regulatory priority - consumer and investor protection

As previously highlighted, the protection of investors and consumers, particularly those investing in crypto-assets, is a priority for both the European supervisory authorities (ESAs) and the Central Bank of Ireland (CBI), both of which recently published warnings to consumers on the risks of investing in crypto-assets. Currently, consumers have very limited rights to protection or redress under EU law in respect of the risks associated with the investment in crypto-assets. Concerns over consumer protection have also increased as, at the time of writing, the value of bitcoin, the largest crypto-currency, has plunged more than 70% from its peak.

Key features

The MiCA preliminary agreement aims to bridge this gap in existing EU legislation and to provide an appropriate level of consumer and investor protection, whilst supporting innovation and the uptake of new financial technologies. The preliminary agreement in respect of the recast FTR aims to enable the EU to deal with the risks of money laundering and terrorist financing linked to crypto-assets, while reconciling competitiveness, consumer and investor protection, and the protection of the financial integrity of the internal market. The key features of both preliminary agreements are set out below:

CASPs

- Under MiCA, CASPs will require an authorisation in order to operate within the EU, with national authorities required to issue such authorisations within a three-month timeframe.
- Regarding the largest CASPs, national authorities will transmit relevant information regularly to the European Securities and Markets Authority (ESMA).
- CASPs will be subject to strong requirements to protect consumer wallets and become liable where they lose investors' crypto-assets.

Non-fungible tokens

- Under MiCA, non-fungible tokens (NFTs), i.e. digital assets representing real objects like art, music and videos, will be excluded from MiCA's scope, except if they fall under existing crypto-asset categories.
- Within 18 months the Commission will be tasked to prepare a comprehensive assessment and, if deemed necessary, a specific, proportionate and horizontal legislative proposal to create a NFT regime.

So-called 'stablecoins'

- MiCA aims to protect consumers by requesting so-called 'stablecoin' issuers to build up a sufficiently liquid reserve, with a 1:1 ratio which is partly in the form of deposits.
- Every so-called 'stablecoin' holder will be offered a claim on the issuer at any time and free of charge, and the rules governing the operation of the reserve will also provide for an adequate minimum liquidity.
- All so-called 'stablecoins' will be supervised by the European Banking Authority (EBA), with a presence of the issuer in the EU being a pre-condition for any issuance.

Asset-referenced tokens

- Under MiCA, the development of asset-referenced tokens (ARTs) based on a

non-European currency, as a widely used means of payment, will be constrained to preserve EU monetary sovereignty.

- Issuers of ARTs will need to have a registered office in the EU to ensure the proper supervision and monitoring of offers to the public of ARTs.

Market abuse

- MiCA creates a crypto specific market abuse regime, which will apply to market abuse related to any type of crypto-transaction or service, notably market manipulation and insider dealing.

Climate change

- Under MiCA, crypto-asset market participants will be required to declare information on their environmental and climate footprint.
- ESMA will develop draft regulatory technical standards on the content, methodologies and presentation of information related to principal adverse environmental and climate-related impacts.
- Within two years, the Commission must provide a report on the environmental impact of crypto-assets and the introduction of mandatory minimum sustainability standards for consensus mechanisms, including the proof-of-work.

AML/CFT

- The recast FTR updates the rules on information accompanying the transfers of funds (the travel rule) by extending the scope of those rules to transfers of crypto-asset.
- The aim of the recast FTR is to introduce an obligation for CASPs to collect and make accessible certain information about the originator and the beneficiary of the transfer of crypto-assets they operate i.e. akin to what payment service providers currently do for wire transfers. This will ensure traceability of crypto-asset transfers in order to be able to better identify possible suspicious transactions and block them.
- The recast FTR requires that the full set of originator information travel with the crypto-asset transfer, regardless of the amount of crypto-assets being transacted. There will be specific requirements for crypto-asset transfers between crypto-asset service providers and un-hosted wallets.
- To avoid any overlaps in legislation, MiCA does not duplicate the recast FTR's provisions in respect of extension of the travel rule to transfers of crypto-assets.
- MiCA does, however, require the following:
 - » that the EBA be tasked with maintaining a public register of non-compliant CASPs
 - » CASPs whose parent company is located in countries listed on the EU list of third countries considered at high risk for money laundering activities, as well as on the EU list of non-cooperative jurisdictions for tax purposes, will be required to implement enhanced checks in line with the EU AML framework
 - » tougher requirements may also be applied to shareholders and to the management of CASPs, notably with regard to where they are located
- In due course, member states will have to ensure that all CASPs qualify as obliged entities under the 4th AML directive. So-called virtual asset service provider (**VASPs**) are already in scope of AML/CFT requirements in Ireland and subject to registration for AML/CFT supervisory purposes.

Sanctions

- The improved traceability of crypto-assets under the recast FTR should make it more difficult for persons and entities, which are subject to restrictive measures, to circumvent them.
- In addition, CASPs will have to implement appropriate internal policies, procedures and controls to mitigate the risks of evasion of national and EU restrictive measures.
- More generally, the entirety of sanctions already apply to all natural and legal persons, including those operating in the crypto-currencies sector.

Next steps

Both preliminary agreements in respect of MiCA and the recast FTR must be approved by the Council and the European Parliament before going through the formal adoption procedure (via Council meeting and plenary respectively). In this regard, the co-legislators have agreed to align the timetable for application of the recast TFR Regulation with the timetable for application of MiCA. The agreed revised texts of the preliminary agreements are yet to be published.

Whilst it is not expected that MiCA or the recast FTR will be adopted prior to next year, crypto-asset issuers and CASPs should factor the above-outlined key features of these provisional agreements into their horizon scanning and compliance risk frameworks.

For further information in relation to this topic, please contact [Kevin Allen](#), Partner, [Patrick Brandt](#), Partner, [Christopher Martin](#), Of Counsel, [Sian Langley](#), Knowledge Lawyer or any member of [ALG's financial regulation team](#).

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