

A close-up photograph of an hourglass with blue sand, set against a solid blue background. The hourglass is positioned vertically, with the top bulb containing a small amount of sand. The sand is falling through the narrow neck into the bottom bulb. The lighting is soft, highlighting the texture of the sand and the glass.

This webinar will begin shortly.

FIA



Key Differences between EU and US Digital Asset Regulation

16 November 2023



Reminders

- The webinar will be recorded and posted to the FIA website within 24 hours of the live webinar.
- Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers.



Presenters

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Presentation Prepared by
WHITE & CASE



Agenda

1 Introduction

2 Issuance

3 Trading

4 Custody



1. Introduction

- MiCAR
- Classification Under MiCAR
- US Classification

EU | Differentiation from MiFID Services

MiCAR only applies where EU financial market law does not already regulate crypto assets or services.

- | | |
|---------------------------------|--|
| MiCAR applies to: | <ul style="list-style-type: none">▪ All entities involved in the issuance, public offering and admission to trading of crypto-assets in the EU (Art. 2(1) MiCAR)▪ All entities providing services in relation to crypto-assets (Art. 2(1) MiCAR), including:<ul style="list-style-type: none">- credit institutions (Art. 60(1) MiCAR)- MiFID investment firms (Art. 60(3) MiCAR)- central securities depositories (Art. 60(2) MiCAR)- electronic money institution (Art. 60(4) MiCAR)- UCITS management companies or alternative investment fund managers (Art. 60(5) MiCAR) |
| MiCAR does <u>not</u> apply to: | <ul style="list-style-type: none">▪ Crypto-assets that qualify as financial instruments pursuant to MiFID (Art. 2(4)(a) MiCAR)▪ Funds, except if they qualify as e-money tokens (Art. 2(4)(c) MiCAR) |

EU | Classification – Crypto-Asset Overview

Crypto-assets according to MiCAR

"a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology or similar technology"

Other crypto-assets
(e.g. crypto currency, utility token)

Asset-referenced Token

"A type of crypto-asset that is not an electronic money token and that aims to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies"

normal token

significant token

E-Money Token

"A type of crypto-asset that purports to maintain a stable value by referencing the value of one official currency"

normal token

significant token

Explicitly excluded:

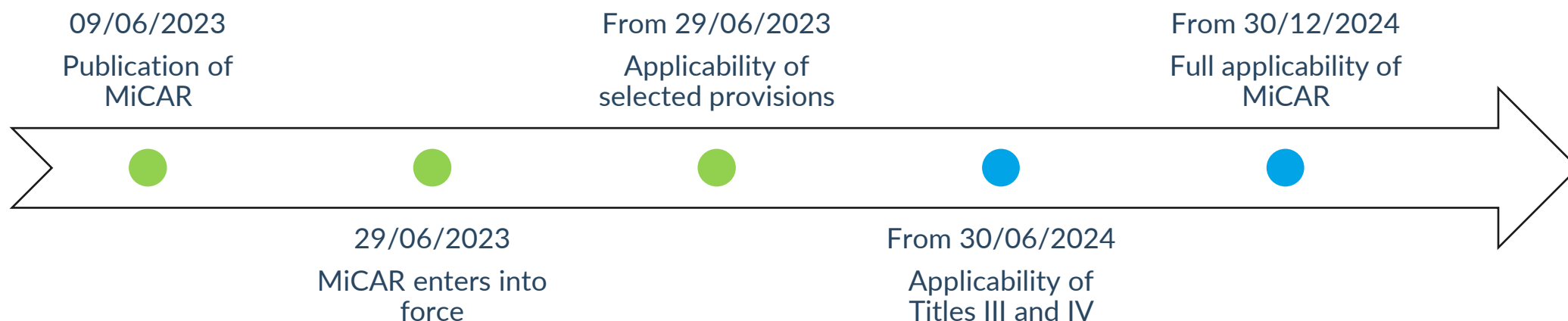
- Financial instruments according to MiFID II
- E-money according to EMD2
- Deposits, including structured deposits
- Non-Fungible-Tokens (NFT), provided they cannot be divided into fractional parts



EU | Classification

Regulation (EU)
2023/1114 (MiCAR)

- MiCAR introduces a harmonised set of rules (including an EU passport procedure)
- MiCAR takes a holistic approach and regulates the public offering/issuance of crypto-assets, requirements for crypto-asset service providers and the provision of crypto-asset services and market infrastructure, and introduces a market abuse regime for trading in crypto-assets





US | Classification – Digital assets as securities

- Existing classification requirements are applied on a case-by-case basis to determine whether a digital asset is a security
 - E.g., investment contracts
- The *Howey* test for determining whether an investment contract exists requires:
 - i. an investment of money,
 - ii. into a common enterprise,
 - iii. with the reasonable expectation of profits,
 - iv. to be derived from the efforts of others.
- Determining whether a particular digital asset constitutes a security is a fact-intensive inquiry
 - Applied to Bitcoin, Ethereum and NFTs, the *Howey* test leads to different outcomes.

Digital assets considered securities by the SEC*

ADA	CHZ	ICP	MIR	SALT
AIR	COTI	IHT	MNGO	SAND
ALGO	DASH	KIN	NEAR	SOL
AMP	DDX	KROM	NEXO	TKN
ATOM	DFX	LBC	NGC	TON
AXS	DRGN	LCX	OMG	TRX
BCC	DUCAT	LOCKE	POWR	UST
BTT	FIL	MANA	RGT	VGX
BUSD	FLOW	MATIC	RLY	XRP
BXT	HYDRO	META1	RYO	

*not exhaustive



US | Classification – Digital assets as security-based swaps

- The SEC’s Security-based swaps regulatory regime also applies to derivatives on digital assets that are “securities”.

“Make no mistake: If a swap is based upon a crypto asset that is a security, then that is a security-based swap. Thus, our rules apply to them ... And furthermore, if platforms – whether in the decentralized or centralized finance space – offer security-based swaps, they are implicated by the securities laws and must work within our securities regime.”

Gary Gensler, SEC Chairman, “A ‘New’ New Era:” Prepared Remarks Before the International Swaps and Derivatives Association Annual Meeting, May 11, 2022



US | Classification – Digital assets as commodities

- Similarly, the commodities and derivatives laws do not specify whether a digital asset is a regulated contract. The CFTC is of the view that many digital assets are commodities subject to its regulation.

“We've been very clear on bitcoin: bitcoin is a commodity. We haven't said anything about ether—until now,.” “It is my view as chairman of the CFTC that ether is a commodity.”

Heath Tarbert, former CFTC Chairman, Yahoo Finance's All Markets Summit in New York City, October 10, 2019

“Digital assets include virtual currencies that are digital representations of value that function as mediums of exchange, units of account, and/or stores of value. Certain digital assets, including BTC, ETH, LTD, and at least two fiat-backed stablecoins, tether and Binance USD, as well as other virtual currencies ... are “commodities”...”

Complaint, Commodity Futures Trading Commission v. Zhao et. al, 1:23-cv-01887 (N.D.Ill. Mar. 27, 2023).



2. Issuance





EU | Public Offering of Crypto-Assets

- In principle, any type of crypto asset requires the **publication of a crypto-asset white paper and its notification to or approval by the competent authority**
- Issuers of an **asset-referenced token (ART)** have to be licenced, except where they are a **credit institution** (Art. 16(1) MiCAR)
- Issuer of an **electronic money token (EMT)** must either be a **licensed credit institution** or an **electronic money institution** (Art. 48(1) MiCAR)



US | Digital assets as securities and security-based swaps

- Digital asset securities are subject to the same securities laws as other securities
- US securities laws require:
 - That offers be registered with the SEC;
 - That offers comply with registration rules; and
 - That registration statements be available to investors
- Available exceptions and exemptions are not widely applicable to digital assets



US | Digital assets as commodities, swaps, futures and options

- Digital asset commodities and swaps may be subject to the following requirements, depending on their classification:
 - swap dealer or security-based swap dealer registration;
 - *futures commission merchant* registration;
 - *commodity pool operator* and/or *commodity trading advisor* registration and the provision of investor disclosure documents
- Digital asset derivatives may not be able to be offered to retail investors
- Retail Commodity Transactions



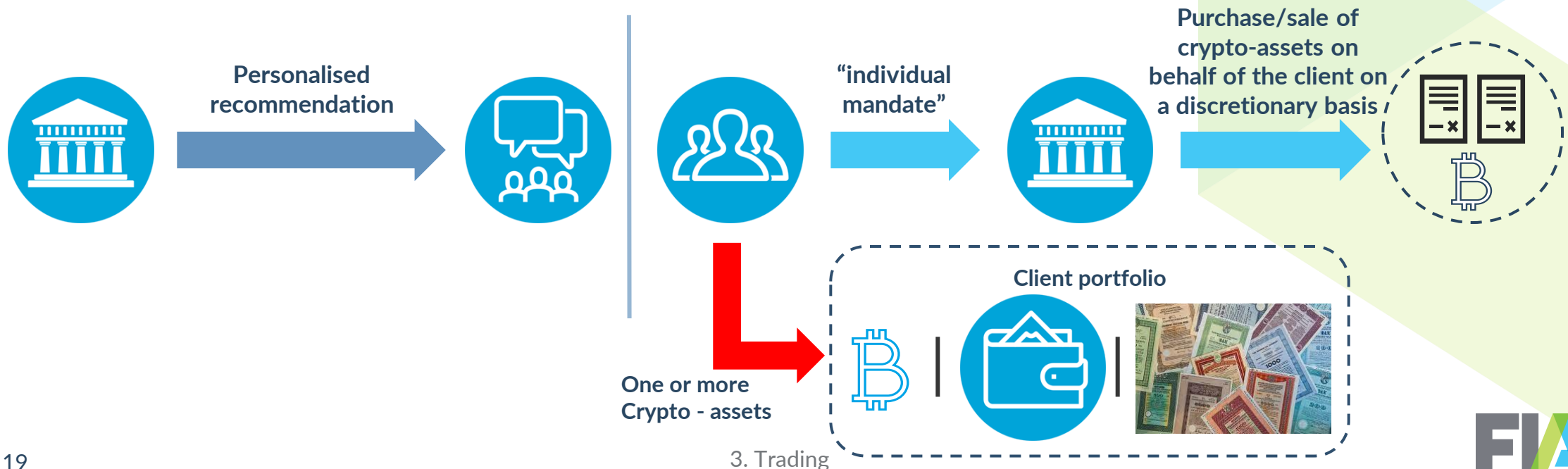
3. Trading



EU | Advice and Portfolio Management (1/2)

Advice: "(...) personalised recommendations (...) in respect of one or more transactions relating to crypto-assets, or the use of crypto-asset services"
(Art. 3(1) no. 24 MiCAR)

Portfolio management: "Managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more crypto-assets"
(Art 3(1) no. 25 MiCAR)



EU | Advice and Portfolio Management (2/2)

Advice	Portfolio Management
Client must be informed in advance of the nature of the advice (Art. 81(2) MiCAR)	
Client exploration (ESMA will publish guidelines on this) / Failure to provide required client information: ban on advice (Art. 81(8),(11) MiCAR)	
Suitability assessment (Art. 81(1) MiCAR) / Selection from a sufficiently diverse range of products (in case of an independent advice, Art. 81(3)(a) MiCAR) / Provision of a report on the suitability test carried out (Art. 81(13) MiCAR)	
Ban on benefits; but benefits may be permitted under strict conditions (in case of an independent advice, Art. 81(3)(b) MiCAR)	Ban on benefits (Art. 81(5) MiCAR)
	Periodic statements (Art. 81(14) MiCAR)
Cost transparency (Art. 81(4) MiCAR) / Competence and expertise requirements for investment advisors and sales staff (Art. 81(7) MiCAR) / Risk warning obligations (Art. 81(9) MiCAR)	Cost transparency (Art. 81(4) MiCAR) / Risk warning obligations (Art. 81(9) MiCAR)

EU | Exchange of Crypto-Assets

Art. 3(1) no. 19 and 20 MiCAR: Conclusion of contracts with clients concerning the purchase or sale of crypto-assets for funds/other crypto-assets by using **proprietary capital**

1

Art. 77(1) MiCAR:
Establishment of a non-discriminatory commercial policy including client criteria

2

Art. 77(2) MiCAR:
Obligation to publish a firm price of the crypto-assets or a method for determining the price

3

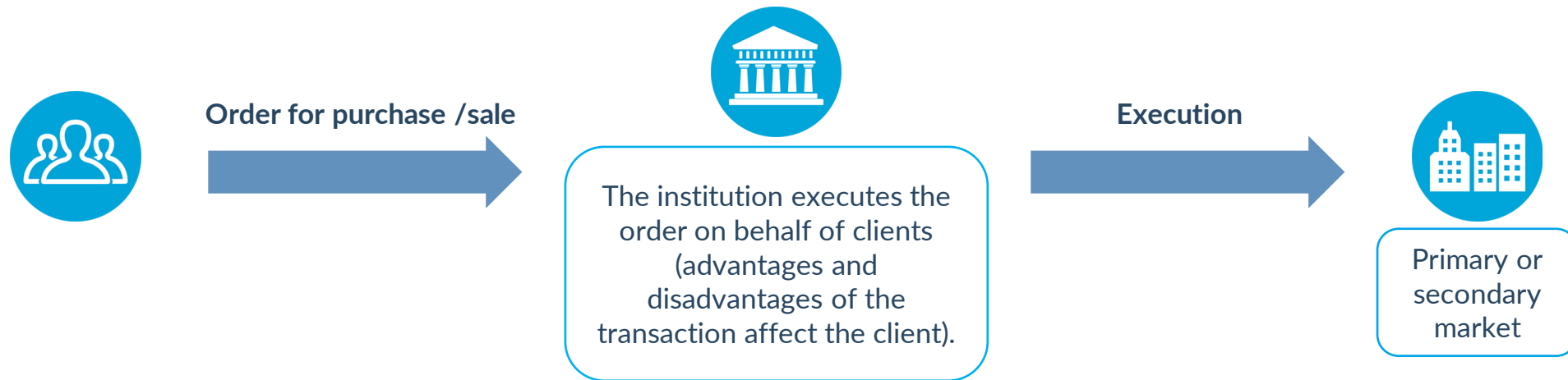
Art. 77(3) MiCAR (Slippage ban):
Execution of client orders at the prices displayed at the time when the order for exchange is "final"

4

Art. 77(4) MiCAR (Transparency Requirements):
Publication of information about the transactions concluded, including transaction volumes and prices

EU | Execution of Client Orders

Art. 3(1) no. 21 MiCAR: “Conclusion of agreements, on behalf of clients, to purchase or sell one or more crypto-assets or the subscription on behalf of clients (...) at the moment of their offer to the public”



Requirements for the execution of orders on behalf of the clients

Art. 78(1),(2) MiCAR: Obligation of best execution based on an execution policy

Art. 78(3) MiCAR: Provision of order execution policy and consent requirement prior to provision of service

Art. 78(6) MiCAR: Consent requirement for execution of client orders outside trading platforms

EU | Reception and Transmission of Client Orders

Art. 3(1) no. 23 MiCAR: “Reception from a person of an order to purchase or sell one or more crypto-assets or to subscribe for one or more crypto-assets and the transmission of that order to a third party for execution”



Requirements for reception and transmission

Art. 80(1) MiCAR: Establishment of procedures and arrangements for prompt and proper transmission

Art. 80(2) MiCAR (Ban on PFOF): Prohibition on receiving remuneration from third parties for the transmission of client orders

Art. 80(3) MiCAR (Ban on Frontrunning): Prohibition on misuse of information relating to pending client orders



US | Digital assets as securities

- Organizations that trade in, or are platforms for trading in, digital assets that are considered securities may need to register as:
 - broker-dealers;
 - an exchange;
 - a clearing agency



US | Digital assets as commodities

- Organizations that trade in, or are platforms for trading in, digital assets that are considered commodities or swaps may need to register as:
 - a *swaps execution facility, derivatives contract market or board of trade*;
 - a swap dealer or security-based swap dealer;
 - a *futures commission merchant*
- Decentralized Finance (DeFi)
 - DeFi operators/facilities have been subjects of CFTC orders stating that such entities should have registered as *futures commission merchants/regulated exchanges*
- Retail Commodity Transactions



4. Custody



EU | Crypto-Asset Services in the Spotlight

Custody and administration

Custody and administration of crypto-assets
(or the access to such crypto-assets)

**Advice and portfolio
management**

Providing advice on and portfolio administration of
crypto-assets

Exchange

Exchange of crypto-assets for other crypto-assets or
funds

**Execution of client orders and
reception and transmission of
orders**

Execution of client orders and reception and
transmission of orders for crypto-assets

EU | Custody and Administration of Crypto-Assets

Art. 3(1) no. 17 MiCAR:
"safekeeping or controlling, on behalf of clients, of crypto-assets or of the means of access to such crypto-assets, where applicable in the form of private cryptographic keys"

Entering into a custody agreement with the clients pursuant to Art. 75(1) MiCAR

Art. 75(2) MiCAR: Keeping a register of positions, opened in the name of each client, corresponding to each client's rights to the crypto-assets

Art. 75(3) MiCAR:
Establishment of a custody policy with internal rules and procedures to ensure the safekeeping and to minimise the risk of loss of client crypto-assets

Art. 75(7) MiCAR: Segregation and "insolvency-proof" custody of crypto-assets held on behalf of clients

Legal liability regulation in case of loss of crypto-assets or means of access attributable to them in Art. 75(8) MiCAR (reversal of the burden of proof)

Outsourcing must comply with the strict requirements of Art. 75(9) MiCAR and the general outsourcing requirements pursuant to Art. 73 MiCAR



US | Digital assets as securities (1/2)

- Investment advisers are subject to the Investment Advisers Act of 1940, which imposes registration requirements, as well a number of rules and regulations
 - E.g., Rule 206(4)-2 (the “Custody Rule”)
 - “client funds or securities”
 - “qualified custodian(s)”
- Open questions:
 - Are cryptocurrencies and other digital assets “funds” under the Custody Rule?
 - How is “control” established over non-physical assets?
 - In custodian insolvency cases, are digital assets held in custody considered part of the bankruptcy estate?



US | Digital assets as securities (2/2)

- In February 2023, the SEC proposed to amend the Custody Rule:
 - Expanded scope: “funds, securities, or other positions held in the client’s account”
 - “possession or control” required for qualified custodians
 - Written agreements, between advisers and qualified custodians, with specified assurances required



US | Digital asset custody under state law

- In October 2023, California passed the Digital Financial Assets Law (DFAL)
 - Comprehensive licensing scheme
 - Record-keeping, disclosure and capital requirements
 - Provides for examinations by regulators, enforcement actions and civil penalties
 - Takes effect July 1, 2025
- Similar to New York’s “BitLicense,” finalized in June 2015



Questions?



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FIA

The logo consists of the letters 'FIA' in a bold, sans-serif font. The 'F' is a solid dark grey. The 'I' is a solid dark grey. The 'A' is composed of two overlapping shapes: a light green triangle pointing upwards and a light blue triangle pointing downwards, which together form the shape of the letter 'A'. The background features large, overlapping geometric shapes in shades of light green, light blue, and light grey.