

MARKETS IN CRYPTO-ASSETS AND CAPITAL MARKET

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Abstract

Crypto-assets are defined as digital representations of value or of rights, applications of distributed ledger technology (DLT), including blockchain technology. DLT means an information repository that keeps records of transactions and that repository is shared across, and synchronised between, a set of DLT network nodes.

Representations of value regarding crypto asset include a value attributed to a crypto-asset by the parties concerned or by market participants. That means the value is based on the interest of the purchaser of the crypto-asset only.

Digital assets that cannot be transferred to other holders do not fall within the definition of crypto-assets. Therefore, digital assets that are technically impossible to transfer directly to other holders should be excluded from the scope of the European Regulation [Regulation (EU) 2023/1114].

Some crypto-assets qualify as financial instruments as defined in Directive 2014/65/EU of the European Parliament and of the Council¹ (MiFID II) and fall within the scope of existing Union legislative acts on financial services. Therefore, a set of rules already applies to issuers of such crypto-assets and to firms conducting activities related to such crypto-assets. But other crypto-assets fall outside of the scope of Union legislative acts on financial services. European legislator chooses to regulate crypto assets that not fall within the regulation of financial instruments outside of this regulation. The new regulation [Regulation (EU) 2023/1114]² intended to legislate in the field of crypto-assets, not interfering with financial instruments.

Somehow similar to financial instruments market architecture the new regulation defines crypto assets types (e-money tokens, 'asset-referenced tokens' and third type outside the two defined types), admission to trading of crypto-assets and offer to the public of crypto assets, crypto-asset services and application for authorization as a crypto-asset service provider or operation of a trading platform for crypto-assets, prevention and prohibition of market abuse involving crypto-assets.

Similar to capital market domain, Member States shall designate the competent authorities responsible for carrying out the functions and duties provided for in the regulation on crypto assets market. Member States shall notify those competent authorities to EBA (European Banking Authority) and ESMA (European Securities and Markets Authority).

Keywords: *crypto-assets, distributed ledger technology (DLT), blockchain technology, crypto-assets services, trading platform for crypto-assets.*

1. Introduction

Markets in crypto-assets based on DLT, including blockchain technology, are global and require a special and harmonised regulation framework. Markets in crypto-assets regulation is therefore necessary at Union level in order to provide specific rules for crypto-assets and related services and activities.

The EU legislator declares its attachment to innovation in the financial field and supports for new technologies, including the usage of DLT. It is expected that many applications of blockchain technology will continue to create new types of business activity that, together with the crypto-asset sector itself, will lead to economic growth and prosperity for Union citizens.

Still, the absence of an overall European framework for markets in crypto-assets is likely to lead to a lack of users' confidence in these assets, which could slow down the development of such a market. Furthermore, companies using crypto-assets would have no reasonable certainty on how their assets would be treated in the other Member States, which would demoralise their energies to digital innovation. The lack of an overall

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¹ Directive 2014/65/EU of the European Parliament and of the Council of 15.05.2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173/12.06.2014, p. 349).

² Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31.05.2023 on markets in crypto-assets (MiCA).

European framework for markets in crypto-assets could also outcome in regulatory fragmentation, which would distort competition in the internal market, make it more difficult for crypto-asset service providers to unify their activities on a cross-border basis³.

This is the framework in which the EU legislator decided a harmonised regulation of crypto-assets through an European Regulation.

2. Paper content

2.1. Crypto-assets at a glance

Crypto-assets refer to a large range of diverse assets whose common feature is that they are a digital representation of value or of a right that is able to be transferred and stored electronically⁴. But there are other digital assets already in circulation. In contrast with those assets, crypto-assets rely on DLT to be transferred and stored. In addition, crypto assets are not backed by a central bank or any other public authority. Summarising the crypto assets features, we can stress what is important as follows: a decentralised ledger and protocols (consensus mechanism) that allow to execute different types of transactions.

2.2. Crypto assets taxonomy

One main approach is to classify crypto-assets in accordance with their declared main purpose. In this line of thought, three different groups are distinguished.

The first group comprises those assets whose primary objective is to serve as a medium of payment or exchange. These are usually named „virtual currencies”⁵.

The second group covers instruments designed for raising capital from investors. Specific procedures are organised to this end, known as Initial Coin Offerings. Investors receive tokens justifying their legal claim to participate in any potential increase in the future value of, or returns on, businesses or specific projects. These tokens may be structured to confer rights equivalent to those of other financial instruments. As they largely overlap with capital market securities, these sectorial regulations apply.

The third group comprises utility tokens, which act as value coupons that can be exchanged for future services, products or benefits marketed through the issuer’s own platform. Such tokens will be subject to regulations on consumer protection, online trading, data protection and business operations, but not financial regulations.

Another classification criteria of the crypto-assets system have to do with the primary nature of each token. Tokens are understood to be a specific unit of digital value, as assembled by an issuing organisation. In some cases, these are named native tokens since they are created with no underlying asset. They are further linked to a specific ledger. This is the case of bitcoin and its blockchain network. The value of these tokens leans on their users’ expectations as to how they may be used in future transactions, rather than a potential cash flow or their issuer’s performance.

In other cases, these tokens are connected to actual real-world assets, real estate for example. This situation allows real estate assets to be broken down into fractions which, in turn, can bear ownership rights and ultimately render such properties more liquid.

An alternative taxonomy distinguishes between traditional crypto-assets and „stablecoins”. In an attempt to stabilise crypto assets value, they are usually backed by other real or virtual assets as a means of collateral. For example, some stablecoins are fixed to legal tender, while others are anchored to commodities, bonds or even other digital assets.

MiCA Regulation defines crypto assets types: *e-money tokens*, *asset-referenced tokens* and third type outside the two defined types⁶.

³ Regulation (EU) 2023/1114 (MiCA), Preamble (5).

⁴ Regulation (EU) 2023/1114 (MiCA), art. 1 (5).

⁵ Bitcoin is the most notable example.

⁶ Regulation (EU) 2023/1114 (MiCA), art. 3 para.1 pt. 5, 6.

Asset-referenced token means a type of crypto-asset (that is not an electronic money token) that proclaims to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies⁷.

Electronic money token or „e-money token” means a type of crypto-asset that proclaims to maintain a stable value by referencing the value of one official currency.

2.3. Capital market pre-eminence

Some crypto-assets qualify as financial instruments as defined in Directive 2014/65/EU of the European Parliament and of the Council⁸ (MiFID II) and fall within the scope of existing Union legislative acts on financial services. Therefore, a set of rules already applies to issuers of such crypto-assets and to firms conducting activities related to such crypto-assets. But other crypto-assets fall outside of the scope of Union legislative acts on financial services.

The EU legislator chooses to regulate crypto assets that do not fall within the regulation of financial instruments but outside of this regulation. The new Regulation⁹ intended to regulate in the field of crypto-assets, not interfering with financial instruments. This means that the field of the capital market keeps its regulatory limits intact. What falls between these escapes MiCA Regulation. But the regulation of the capital market somewhat remains a blueprint for crypto assets regulation. To clarify: MiCA spends articles to define crypto assets, to implement crypto asset services and crypto asset services providers. The regulation obliges providers to obtain the necessary authorisation, as well as also sets out various prudential, organisational and transparency requirements, as well as others relating to the safekeeping of clients' funds, conflicts of interest and outsourcing, depending on the service provider's characteristics. Market abuse, competent authorities and penalties are also present under the MiCA regime.

The legislator of the European Union considered that MiFID on the capital market was a success that should be replicated on crypto assets market in MiCA Regulation.

2.4. Crypto asset services and crypto asset services providers

Crypto-asset services include any of the services and activities relating to any crypto-asset as follows¹⁰.

Providing custody and administration of crypto-assets on behalf of clients means the safekeeping, on behalf of clients, of crypto-assets or of the means of access to such crypto-assets (in the form of private cryptographic keys).

Operation of a trading platform for crypto-assets means the administration of a multilateral systems, which bring together of multiple third-party purchasing and selling interests in crypto-assets, in the system and in accordance with its rules, in a way that results in a contract, by exchanging crypto-assets either for funds or for other crypto-assets. The similarities with the regulated market of financial instruments are not unintended. That market represents the pattern followed.

Exchange of crypto-assets for funds or for other crypto-assets. Exchange of crypto-assets for funds involves the concluding of purchase or sale contracts regarding crypto-assets with clients for funds by using their capital and exchange of crypto-assets for other crypto-assets means the conclusion of purchase or sale contracts concerning crypto-assets with clients for other crypto-assets.

Execution of orders for crypto-assets on behalf of clients means the conclusion of agreements, on behalf of clients, to purchase or sell one or more crypto-assets or the subscription on behalf of clients for one or more crypto- assets.

Placing crypto-assets means the marketing, on behalf of or for the account of the offeror of crypto-assets to purchasers.

Reception and transmission of orders for crypto-assets on behalf of clients means the 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.

⁷ Regulation (EU) 2023/1114 (MiCA), art. 1 (6).

⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15.05.2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173/12.06.2014, p. 349).

⁹ Regulation (EU) 2023/1114 (MiCA).

¹⁰ Regulation (EU) 2023/1114 (MiCA), art. 3 para. 1 pt. 16.

Providing advice on crypto-assets means offering recommendations to a client, either at the client's request or on the initiative of the crypto-asset service provider providing the advice, in respect of one or more transactions relating to crypto-assets, or the use of crypto-asset services.

Providing portfolio management on crypto-assets means 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.

Providing transfer services for crypto-assets on behalf of clients means providing services of transfer, on behalf of a natural or legal person, of crypto-assets from one distributed ledger address or account to another.

Crypto-asset service provider means an undertaking whose business is the delivery of one or more crypto-asset services to clients on a professional basis (and that is allowed to provide crypto-asset services in accordance with MiCA Regulation). A person shall not provide crypto-asset services, within the Union, unless that person is a legal person or other undertaking that has been authorised as crypto-asset service provider after submitting their application for an authorisation as a crypto-asset service provider to the competent authority of their home Member State¹¹. Still, some exception, following a notification are granted to credit institution, central securities depository (for custody and administration of crypto-assets on behalf of clients), investment firm (for crypto-asset services in the Union equivalent to the investment services and activities for which it is specifically authorised), market operator, electronic money institution, UCITS management company or an alternative investment fund manager (for crypto-asset services equivalent to the management of portfolios of investment and non-core services for which it is authorised under Directive 2009/65/EC or Directive 2011/61/EU).

Crypto-asset service providers are subject to certain organisational requirements. The members of the management body of crypto-asset service providers should not have been convicted of any offence in the field of money laundering or terrorist financing or of any other offence that would affect their good repute. The shareholders or members should be of sufficiently good repute and should, in particular, not have been convicted of any offence in the field of money laundering or terrorist¹²

Crypto-asset service providers should employ management and staff with adequate knowledge and expertise and should take all reasonable steps to perform their functions¹³. They should have sound internal control and risk assessment mechanisms as well as adequate systems and procedures to ensure the integrity and confidentiality of the information received. Crypto-asset service providers should have appropriate arrangements to keep records of all transactions, orders and services related to the crypto-asset services that they provide. They should also have systems in place to detect potential market abuse committed by clients¹⁴.

2.5. Competent authority

For the purposes of ensuring a clear delineation between crypto-assets covered by this regulation and financial instruments, ESMA should issue guidelines on the criteria and conditions for the qualification of crypto-assets as financial instruments. In order to promote a common approach towards the classification of crypto-assets, the European Supervisory Authorities (EBA, ESMA and EIOPA) should promote discussions on such classification.

Besides known European authorities, EBA and ESMA, Member States shall designate the competent authorities responsible for carrying out the functions and duties provided for in MiCA Regulation. In fact, Member States shall notify those competent authorities to EBA and ESMA.

Competent authority regarding crypto assets means one or more authorities designated by each Member State concerning offerors, persons seeking admission to trading of crypto-assets, issuers of crypto-asset and service providers or designated by each Member State concerning issuers of e-money tokens¹⁵. Such authorities shall have the extensive powers laid down by European regulation¹⁶.

¹¹ Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31.05.2023 (MiCA), art. 62.

¹² Directive (EU) 2015/849 of the European Parliament and of the Council of 20.05.2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) no. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141/05.06.2015, p. 73).

¹³ Regulation (EU) 2023/1114 (MiCA), art. 68.

¹⁴ Title VI, Regulation (EU) 2023/1114 (MiCA).

¹⁵ Directive 2009/110/EC.

¹⁶ Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31.05.2023 (MiCA), art. 94.

3. Conclusions

At the European level, MiCA Regulation is a regulatory initiative that offers a set of uniform rules and a supervisory architecture to provide legal certainty and appropriate legal protection for crypto-assets users.

As a declared principle, any European legislative act adopted in the field of crypto-assets should be „specific and future-proof”, be able to keep pace with innovation and technological developments and be founded on an incentive-based approach. Therefore, the terms „crypto-assets” and „distributed ledger technology” should be defined as widely as possible to capture all types of crypto-assets that currently fall outside the scope of Union legislative acts on financial services.

MiCA Regulation has much in common with capital market architecture. EU choose to treat crypto-assets separately from financial instruments but kept their infrastructure architecture pattern. MiCA turns out to be a pendant for MiFID. MiCA covers multiple types of crypto-assets, service for crypto assets, regulated market for crypto assets and crypto asset service providers rules. The regulation obliges providers to obtain the necessary authorisation, as well as also sets out various prudential, organisational and transparency requirements, as well as others relating to the safekeeping of clients’ funds, conflicts of interest and outsourcing, depending on the service provider’s characteristics.

Thereby facilitating the orderly development of this crypto system, EU is in the vanguard of crypto world.

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