



MERKLE SCIENCE

# CRACKING MiCA

The Must-Know for  
Crypto-Asset Provider



April 2023

# Table Of Contents

<b>The Making of MiCA</b>	<b>01</b>
<b>Scope of MiCA Regulations</b>	<b>02</b>
a. Next Steps	
<b>What is the Crypto Asset Taxonomy under MiCA</b>	<b>03</b>
a. 3 Key Distinctions Between ART and EMT Tokens	
b. Crypto Assets Covered Under MiCA	
c. Understanding ARTs and EMTs under the MiCA Regime	
d. Test of Significance	
e. Crypto assets not covered under MiCA	
<b>Key Regulatory and Prudential Requirements for CASPs under MiCA</b>	<b>04</b>
<b>MiCA Regulation: What CASPs Need to Know</b>	<b>05</b>
AML/CFT Requirements for CASPs under MiCA	

## The Making of MiCA

As is evident in the passing of the general data protection regulation (GDPR), the European Union has been at the forefront of regulating the digital economy. In April 2023, the EU homed in further on cryptocurrency with the EU Parliament's approval of the Markets in Crypto Act (MiCA).

*As one of the most comprehensive regulatory frameworks for digital assets to date in the world, MiCA provides much-needed clarity and regulatory oversight into the space for existing and would-be players. MiCA is one pillar in the EU's Digital Finance Package, coming after the Pilot Regime on Distributed Ledger Technology in June 2022 and the Digital Operational Resilience Act in November 2022.*

# Crypto-assets: green light to new rules for tracing transfers in the EU

Press Releases [PLENARY SESSION](#) [ECON](#) 20-04-2023 - 12:44

- Uniform legal framework for crypto-assets markets in the EU
- Operations with crypto-assets will be traced in the same way as traditional money transfers
- Enhanced consumer protection and safeguards against **market manipulation and financial crime**

### Uniform EU market rules for crypto-assets

Plenary also gave its final green light with 517 votes in favour to 38 against and 18 abstentions, to new common rules on the supervision, consumer protection and environmental safeguards of crypto-assets, including crypto-currencies ([MiCA](#)). The draft law [agreed informally](#) with the Council in June 2022 includes safeguards against market manipulation and financial crime.

## Scope of MiCA Regulations

With its passing in the European Union parliament, MiCA does not need further approval at the national level of any individual EU countries. MiCA goes into effect automatically and uniformly to all 27 countries of the European Union, which provides a consistent, region-wide approach to regulating the industry across all these individual markets. An exchange in Germany must follow the same requirements as a custodian in Italy, for example. These businesses are also spared the hassle of complying with 27 different regulatory frameworks.

Affected businesses must register with their relevant national authorities, comply with anti-money laundering (AML) and counter-financing of terrorism (CFT) requirements, and adhere to policies and standards relating to transparency, disclosure, authorization, and supervision of transactions. The businesses that must comply with MiCA include crypto-asset service providers, such as exchanges, custodians, token issuers, traders, and wallet providers.

## Next Steps

**01**

The European Parliament has approved the regulations, but they still need to be formally adopted by the Council of the European Union before they can be published in the Official Journal.

**02**

Once adopted, MiCA will come into force 20 days after publication in the Official Journal of the EU.

**03**

MiCA will apply in EU member states in stages, with rules for asset-referenced tokens and e-money tokens applying 12 months after entry into force.

**04**

Rules for all other crypto-asset service providers and their activities will apply 18 months after entry into force.



## What is the Crypto Asset Taxonomy under MiCA

As a regulatory framework, MiCA is strong because it provides clear definitions and distinctions, much to the benefit of all ecosystem stakeholders. *At a foundational level, MiCA defines a crypto asset as any digital representation of value or rights that can be stored or transferred electronically using distributed ledger or similar technology.*

MiCA breaks down crypto assets further, segmenting those that it covers from those it does not. MiCA aims to establish a single regulatory framework for digital assets in the European Union, replacing the current fragmented regulatory landscape. This unified approach seeks to create a level playing field for digital asset businesses and provide greater protection to consumers. By setting clear rules for the issuance and trading of ARTs and EMTs, MiCA aims to mitigate risks such as fraud and market manipulation.

MiCA regulation classifies tokens into two categories – **asset-referenced tokens** (ARTs) and **electronic money tokens** (EMTs). ARTs reference assets such as commodities or fiat currencies and are subject to regulations protecting consumers and market integrity. On the other hand, EMTs are electronically stored monetary value, similar to prepaid cards or digital wallets, and require stricter regulatory requirements, including licensing and maintaining a minimum level of capital.

It's important to note that MiCA also includes a third category of tokens known as "utility tokens." However, utility tokens are not considered a separate type of token under the regulation. Instead, they are a subset of ARTs, representing tokens that provide access to a product or service but do not reference an underlying asset.

## 3 Key Distinctions Between ART and EMT Tokens

- 1. Issuance and governance:** Electronic Money Tokens (EMTs) are issued by an electronic money institution (EMI) and are governed by the EMI's own rules and regulations. In contrast, Asset-Reference Tokens (ARTs) are issued by an issuer that is not an EMI, and are backed by a specific asset or basket of assets, which can be physical or virtual. (Article 3(1) and 3(13))
- 2. Redemption:** EMTs are redeemable at any time for their nominal value, whereas ARTs can only be redeemed for the underlying asset or basket of assets. (Article 3(1) and 3(13))
- 3. Regulation:** EMTs are subject to MiCA's specific requirements for electronic money, including capital requirements, safeguarding of funds, and periodic reporting to the competent authorities. ARTs, on the other hand, are not subject to these specific requirements, but are subject to MiCA's general requirements for crypto-assets, including rules on custody, disclosure of information, and market abuse. (Article 18(1) and 18(2))

## Crypto Assets Covered Under MiCA

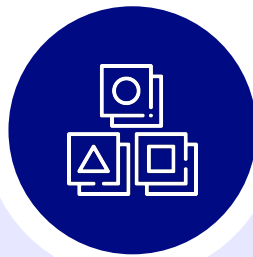
MiCA will cover crypto-assets that are not regulated by existing financial services legislation. Key provisions for those issuing and trading crypto-assets (including asset-reference **tokens** and e-money **tokens**) cover transparency, disclosure, authorisation and supervision of transactions. Consumers would be better informed about the risks, costs and charges linked to their operations. In addition, the new legal framework will support market integrity and financial stability by regulating public offers of crypto-assets.



### Electronic money tokens (EMT)

These represent a claim on the issuer that they can be redeemed at par value on request. Because these tokens are redeemable for fiat currency, they are also subject to the Electronic Money Directive.

**Examples:** USD Coin (USDC) or Tether (USDT)



### Asset-referenced tokens (ART)

These refer to an asset or a basket of assets, such as commodities or currencies. Because their value is derived from the underlying assets they represent, they are not meant to be a store of value on their own.

**Examples:** Paxos Standard (PAX)



### Utility tokens

These provide access to a product or service, often a blockchain-based ecosystem where they are tradeable.

**Examples:** Ether (ETH) and Basic Attention Token (BAT)

## Understanding ARTs and EMTs under the MiCA Regime

Stablecoins are classified as either ARTs or EMTs and there are clear requirements for each. This regime applies to issuers of stablecoins, such as ARTs and EMTs.

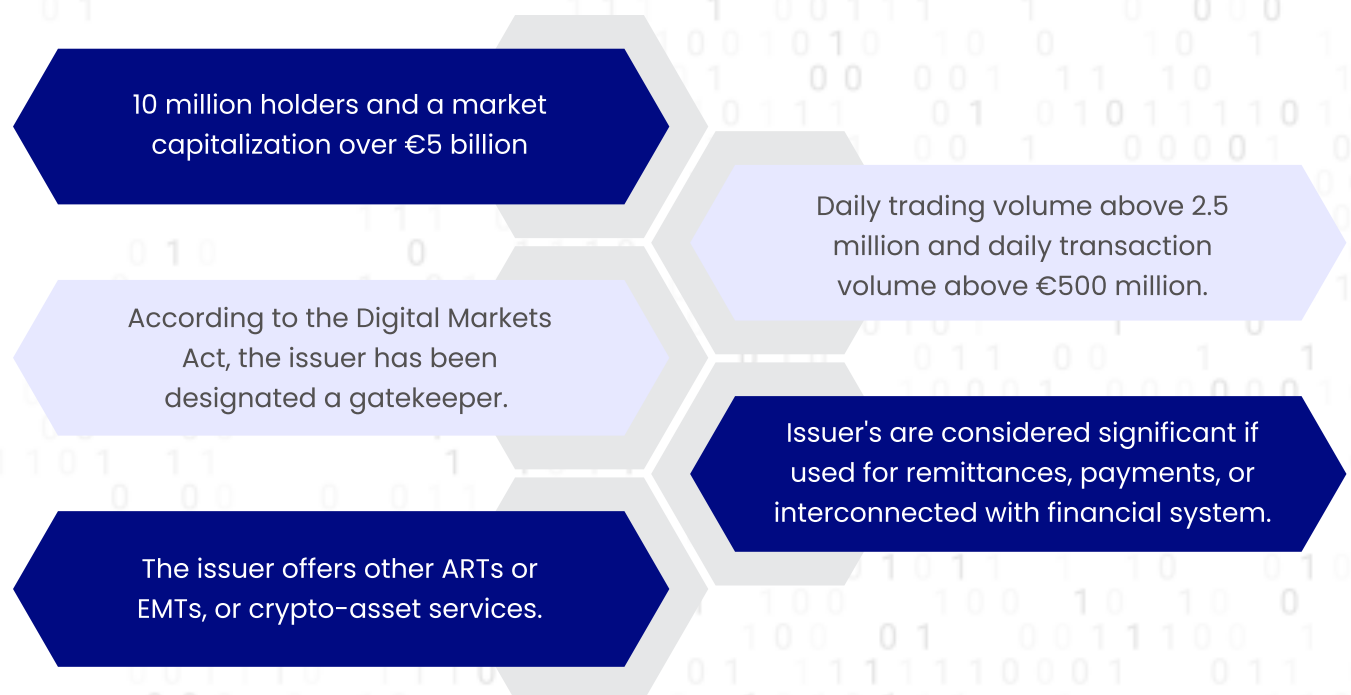
	ARTs	EMTs
Issuer	<p>Before issuing ARTs, issuers must obtain authorization from their relevant national authority, maintain reserve funds in low-risk assets to ensure the token's stability, and publish a white paper about the token. Issuers must also disclose the risks and workings of their token, undergo a yearly audit by an independent auditor, and protect their systems through appropriate cybersecurity measures.</p> <p>*ART issuers who also provide custody or exchange services must also adhere to the requirements for CASPs.</p>	<p>The issuer must be a legal person established in the EU, hold funds equal to the value of the EMTs issued, and comply with AML/CFT requirements.</p>
Token	<p>The ART must give its holders the ability to redeem the token at par value.</p>	<p>currencies, issued at a price equal to the par value of funds held, and used only for payment transactions, where it should be redeemable at par value. The EMT should not be subject to significant fluctuations in value, nor be used for speculation.</p>

## Test of Significance

MiCA also introduces an important concept known as significance. Issuers that pass a test of significance will be subject to greater prudential, governance, and liquidity requirements.

Under MiCA regulations, stricter provisions will apply to issuers of asset-referenced tokens classified as "significant."

- For ARTs, if a token is classified as "significant," the issuer will be subject to more stringent provisions to protect consumers and market integrity.
- The criteria for determining the significance of ARTs includes providing core platform services designated as gatekeepers under the Digital Market Act and international activity outside the EU.
- Additionally, MiCA regulations will require issuers of EMTs to be authorized credit institutions or electronic money institutions and comply with applicable sectoral legislation.
- MiCA regulations also set out rules for categorizing certain EMTs as "significant," subjecting them to additional requirements and supervision.





## Crypto assets not covered under MiCA



### **Central Bank Digital Currencies (CBDCs)**

Because these are issued by central banks, MiCA does not consider these crypto assets.



### **Financial instruments**

These fall under EU's MiFID II Directive, even if the financial instruments are represented in digital form.



### **Security Tokens**

Because these are tokens that represent traditional financial instruments, they are already regulated under EU securities regulations.



### **Payment tokens**

Compared to utility tokens, payment tokens can only be used for remuneration exclusively within a given product, service, or ecosystem.



### **Product-specific tokens**

Like payment tokens, these can only be used within a given product, service, or ecosystem.



### **Non-fungible tokens**

NFTs are not clearly defined in terms of regulation under MiCA. While NFTs issued as part of a large collection may be considered non-fungible and subject to MiCA, other NFTs would fall outside its scope. The definition of a large collection is unclear and will likely require case-by-case rulings to determine.

The MiCA has set minimum requirements for CASPs to ensure their proper governance and safekeeping of assets. These requirements are designed to ensure that CASPs provide their services in a safe and sound manner and protect the interests of their clients. By adhering to these requirements, CASPs can operate in a regulated environment that promotes market integrity, investor protection, and financial stability.

## Key Regulatory and Prudential Requirements for CASPs under MiCA

- **Authorization:** All CASPs must obtain authorization from the competent authority of the Member State where they are established or provide services. **(Article 20)**
- **Organizational Requirements:** CASPs must have effective corporate governance arrangements, including internal control mechanisms, compliance policies, and sound administrative and accounting procedures. **(Article 26)**
- **Capital Requirements:** CASPs must maintain a minimum level of capital at all times. The capital requirement varies depending on the type of service provided. **(Article 22)**
- **Segregation of Client Assets:** Custody service providers must segregate clients' assets from their own assets and maintain adequate records. **(Article 44)**
- **Conduct of Business Rules:** CASPs must conduct business in a fair, transparent, and non-discriminatory manner. They must also ensure that their clients are adequately informed about the risks and costs associated with crypto-assets. **(Article 47)**
- **Safeguarding of Client Funds:** CASPs must safeguard client funds and hold them in separate accounts. **(Article 43)**
- **Cybersecurity Requirements:** CASPs must establish and implement robust and effective cybersecurity measures to protect their systems and data from unauthorized access or attack. **(Article 24)**
- **Anti-Money Laundering (AML) and Counter:** Terrorist Financing (CTF): CASPs must have effective AML and CTF policies and procedures in place, including customer due diligence, ongoing monitoring, and suspicious transaction reporting. **(Article 57)**
- **Record-Keeping Requirements:** CASPs must keep accurate and up-to-date records of their transactions and clients for a minimum of five years. **(Article 29)**

**Audit and Reporting Requirements:** CASPs must undergo regular audits by independent auditors to ensure compliance with MiCA requirements. They must also submit annual reports to the competent authority. **(Articles 25 and 37)**

## MiCA Regulation: What CASPs Need to Know

The new MiCA Regulation has established a regulatory framework for Crypto-Asset Service Providers (CASPs) and issuers.

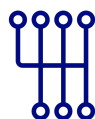
Essentially, "CASPs" refer to entities that provide services related to crypto-assets, including custody, exchange, transfer, and trading of crypto-assets. Any CASP that falls into one of the following possible categories has to comply with requirements relating to governance, outsourcing, prudential provisions, information disclosure, complaint handling, asset safekeeping, and even wind-down plans.



Exchange of  
crypto-assets for  
other crypto-assets



Custody and  
administration of  
crypto-assets



Reception and  
transmission of orders  
for crypto-assets



Operation of a  
crypto-asset  
trading platform



Custody and  
administration of  
crypto-assets



Exchange of  
crypto-assets for  
fiat currency

## AML/CFT Requirements for CASPs under MiCA

## Article



Under MiCA, CASPs are required to comply with several AML/CFT requirements. The first key point is that CASPs must apply a risk-based approach to identify, assess, and mitigate money laundering and terrorist financing risks. Secondly, CASPs must conduct CDD on their customers, including verifying their identity, assessing their risk level, and monitoring their transactions. In addition, CASPs must maintain records of customer identification data and transaction records.

Thirdly, CASPs must apply ED) measures for higher-risk customers, such as Politically Exposed Persons (PEPs) and high-risk third countries. Fourthly, CASPs must have systems and procedures in place to detect and report suspicious transactions to competent authorities, as well as maintaining records of STRs for at least five years. Fifthly, CASPs must continuously monitor their customers' transactions for suspicious activities and take appropriate measures if any are detected. Lastly, CASPs must cooperate with competent authorities and share information when required by law and have procedures in place to ensure the confidentiality and protection of shared information.





# MERKLE SCIENCE

## About Merkle Science

Merkle Science provides predictive blockchain risk intelligence and monitoring services that empower compliance teams to prevent illicit cryptocurrency activities and exceed regulatory requirements with confidence. We've raised over \$27MM in funding from top-tier investors and are the leading innovator in blockchain analytics. Our solutions power over 100+ crypto companies, law enforcement agencies, and financial institutions.

### Contact us

✉ [contact@merklescience.com](mailto:contact@merklescience.com) 🌐 [www.merklescience.com](http://www.merklescience.com)

### Follow Us



[merklescience](https://www.linkedin.com/company/merklescience)



[@MerkleScience](https://twitter.com/MerkleScience)



[merklescience](https://www.facebook.com/merklescience)



[Merkle Science](https://www.youtube.com/MerkleScience)