BLOCKCHAIN IRELAND

Crypto-Assets Paper

September 2024

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ACKNOWLEDGEMENTS
Joint endeavors are tricky things to get right. Too much of one ingredient turns a delicate custard into scrambled eggs, while the method of cooking determines whether you get an omelette - a harmonious blend – or a chaotic scramble. Very often what starts out as an unanimously agreed good idea, becomes, as work progresses, viewed as a less good idea, a terrible idea and finally settles on an OK idea. Here, I think we got the ingredients and cooking right, ending up with what was and remains a good idea.

The legal & regulatory working group is one of a number of Blockchain Ireland industry and sector focused working groups, claiming to be the largest and longest standing'It contains a great mix of lawyers, both in-house & private practice, as well as regulatory professionals, both in-house and consultants. We have members from the large law firms and specialist FinTech firms, from the big consulting houses and niche houses, from the high-street banks and neo-banks, from the large crypto exchanges and small Web3 start-ups, from academia and public bodies. All members share a common interest in learning and pooling knowledge. The idea of compiling a report on Ireland specific aspects of what MiCAR terms 'crypto-assets' as well as what are generally termed 'smart legal contracts' is an idea the working group discussed, divided itself into focused sub-groups to consider and executed on. The sub-groups operated under the tireless stewardship of Chris Martin and Deborah Hutton, respectively. Working group members decided which sub-group they wished to participate in, and both were well staffed. I chair the legal & regulatory working group and am extremely grateful to the sub-group members and especially to Chris and Deborah for their tireless attention to report writing.

The crypto-asset report is the first of our reports to be published. The smart legal contract report will follow on shortly. The two reports have some inevitable crossover, which each report deals with. This crypto-asset report is a solid piece of legal and regulatory analysis, neatly summarising issues and giving where necessary an Ireland focus twist to the analysis. The report is not intended (to mis-quote an old Woody Allen movie title) as everything you always wanted to know about crypto assets (but were afraid to ask). Rather, it gives an Irish law and regulation focused twist to its analysis. It will, I believe, be welcomed by 'Ireland Inc', the legal and regulatory sectors, those interested in crypto-assets, as well as the crypto-asset industry.

Chris will follow up this general introduction with a sub-group and report specific introduction. In conclusion, with thanks to Chris and his sub-group members, this report is intended if not to entertain then at least to inform.

Pearse Ryan
Chair, Blockchain Ireland Legal and Regulatory Working group

As noted by Pearse, the genesis of this Report was to provide a broad legal and regulatory overview of the treatment of crypto-assets and financial regulation in Ireland as it relates to them, and to demonstrate both the challenges and opportunities which Ireland represents as a jurisdiction from which to do business related to crypto-assets, both issuing and servicing. The potential impact of financial regulation, existing and upcoming, on proposed business models and ideas cannot be understated and need to be carefully considered before going to market. Whilst it is not intended to be the be-all and end-all in relation to crypto-assets, we hope that the Report provides a useful reference guide for those already practicing in the crypto-assets space, as well as those considering setting up in Ireland.

It has been a pleasure working with the sub-group, made up of experts from industry, law, and other varied areas of practice, who contributed to the discussions on the content and nature of the Report, as well as to its drafting, research, and proof-reading. Everyone's input and time was willingly given and incredibly valuable, and without these contributions the paper would not have been possible. I would therefore like to thank all of the working group members for their insight, suggestions, and patience, in
helping to prepare this Report.

We hope that you find the Report helpful and informative.

Chris Martin
Chair, Blockchain Ireland Digital-Assets Sub-Group

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Disclaimer: The contents of this report are provided as guidance. Whilst every effort has been made to ensure the accuracy of the Report's contents the authors accept no responsibility or liability for reliance thereon. This Report does not constitute legal advice. If you require professional or legal advice you should consult a qualified professional.

1 INTRODUCTION

1.1 This paper aims to provide an overview of the treatment of digital / virtual / crypto-assets in Ireland (we have used the phrase 'crypto-assets' generally in this paper for consistency). Crypto-assets are broader than just crypto-currencies, being "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" (the definition used in the Markets in Crypto-Assets Regulation **(MiCAR)**). This will include various different types of instruments, tokens, and other novel products, that seek to use distributed ledger technology, or similar novel digital and technological approaches, to represent, store and transfer value, creating new and additional questions around their legal and regulatory treatment.

1.2 The treatment of crypto-assets gives rise to a number of potential issues, with examples including the treatment and categorisation of the assets from a legal perspective, jurisdictional issues owing to their often decentralised nature, as well as regulatory questions and developments which aim to bring service providers within the scope of more general financial services regulation. This paper is the first of two, with a subsequent paper focused on Irish law aspects of smart legal contracts.

1.3 Cryptocurrencies and crypto-assets are not currently subject to a bespoke legislative framework (pending the implementation of the MiCAR) in Ireland, with some exceptions. Nevertheless, it is still possible, for crypto-assets and services linked to crypto-assets to fall within with one or more of the existing financial regulatory frameworks when operating in Ireland, as well as attracting specific regulatory obligations, for example in relation to anti-money laundering and countering the financing of terrorism **(AML/CFT)**.

1.4 From a business perspective, Ireland offers a good base for fintech and crypto-asset businesses within the EU, with an educated, English-speaking, relatively young workforce, low corporate taxes, and a high standard of living. As we discuss in this paper and its accompanying smart-legal-contract paper, Ireland also has a generally supportive and flexible legal system which is able to effectively consider and determine some of the legal challenges associated with crypto-assets.

1.5 The Irish Government has also been focussed on making Ireland attractive to new and existing fintechs and financial services firms, originally through its IFS 2020 Paper, and more recently with the follow-on Update to Ireland for Finance Action Plan 2023, setting out the Irish Government's vision and strategy for Ireland's international financial services sector through to 2026. As stated in the 2023 Action Plan:

> *"[C]urrent estimated figures, for the end of 2022……….indicate that around 56,000 people are in direct employment in the international financial services sector. This is an increase of over 3,000 in the numbers employed at the end of 2021 and is a testimony to the importance of the sector to our economy".*

1.6 We have no particular figures for employment numbers in the digital asset and broader DLT sector, but they are undoubtedly growing and, while the job numbers will never be huge, given the tech based nature of the sector, the additional regulatory requirements and scrutiny under MiCAR are likely to increase these numbers. Salaries also tend to be well above average. In addition, the Central Bank of Ireland (the **Central Bank**) published its priorities for 2023 which include commitment to implement MiCAR.

1.7 Although this Paper is not legal or regulatory advice, and it will be necessary to assess any proposed crypto-assets services on a case-by-case basis, this paper considers these areas and provides an overview of the existing and anticipated Irish legal and regulatory landscape relating to crypto-assets. We also hope the paper will assist people who may be looking to set up operations relating to or involving crypto-assets in Ireland. Of course, given this paper is written by legal and regulatory professionals, it is not intended to replace fact-specific advice, but is hopefully a useful general guide.

1.8 This paper seeks to provide a broad overview of the general legal treatment of crypto-assets, as well as a detailed consideration of the regulatory treatment of crypto-assets and associated services provider. In terms of the regulatory treatment of crypto-assets and associated service providers, this paper considers the following areas of regulation:

- e-money
- payment services
- financial instruments and investment services
- funds, both treatment as, and investment by funds in, crypto-assets
- money laundering and terrorist financing
- the soon to be implemented MiCAR.

A GENERAL LEGAL TREATMENT OF CRYPTO-ASSETS

1 INTRODUCTION

1.1 The novel nature of crypto-assets means that the legal nature of the asset has yet to be firmly defined at law. Jurisdictions therefore turn to existing legal frameworks to determine how and if they can be dealt with appropriately under local laws (such as under the Howey Test or the Commodity Exchange Act in the US), or if a new sui generis / bespoke approach is required (as has been recently proposed in the UK). There are also questions to be answered around how such assets should be treated contractually. For example, in terms of contract formalities, clear jurisdictional issues exist with crypto-assets given their decentralised nature. There are undoubtedly many other areas of general law where the nature and treatment of crypto-assets will create new and difficult questions (e.g. tax, inheritances etc.), many of which are beyond the scope of this paper. However, we note some here of these potential legal issues, as well as why, in practice, the Irish legal system is well-placed to deal with them.

1.2 As mentioned above, a separate paper has been prepared by Blockchain Ireland which considers the contractual issues associated with smart legal contracts in more detail. There is some necessary and unavoidable overlap in scope between the two papers and we summarise below some of the areas dealt with in the smart legal contract paper which naturally fall within the scope of this paper. It should be noted that we are not discussing 'smart contracts' generally but 'smart legal contracts'. A neat distinction was set out by the UK Law Commission in their 2021 report to Government, following the earlier UK Jurisdictional Taskforce legal statement on crypto assets and smart legal contracts:

> *"[E]merging technologies, such as distributed ledgers,*

are increasingly used to create 'smart contracts': computer programs which run automatically, in whole or in part, without the need for human intervention. Smart contracts can perform transactions on decentralised cryptocurrency exchanges, facilitate games and the exchange of collectibles between participants on a distributed ledger, and run online gambling programs. Smart contracts can also be used to define and perform the obligations of a legally binding contract. It is this specific type of smart contract – a 'smart legal contract'"

That is the object of our analysis. Unless the context points to the contrary, all references in this paper to smart contracts refer to smart legal contracts.

2 PROPERTY RIGHTS AND CONTRACTUAL TREATMENT

2.1 The concept of property under Irish law is cast broadly and generally. This can include rights and ownership in and of property, both real and personal (and the attendant rights associated with it), as well as rights to take enforcement action (chose in action) relating to property. Whether a particular crypto-asset will be property in and of itself, such that it has property or ownership rights associated with it, or whether ownership of the crypto-asset would only give rise to a right of action for certain reliefs, will necessarily depend on the precise nature of the asset. Certain crypto-assets may also provide both, or may otherwise be linked to other real-world assets (including 'real-world-assets'). The Irish common law is sufficiently flexible to accommodate new and novel structures within existing legal frameworks and concepts, including the nature and extent of property rights linked with crypto-assets. That crypto-assets are generally considered to be an "asset" was also recently recognised in the Consultation Paper on the draft Guidelines on the conditions and Criteria for the qualification of crypto-assets as financial instruments published by the European Securities and Markets Authority **(ESMA)** on 29 January 2024 **(ESMA Consultation Paper)**.

2.2 Similarly, the legal assessment of contracts in Ireland is subject to common law principles. These include that a contract must involve: a) an offer; b) acceptance; c) consideration; and d) the intention to create legally binding relations. Any legally enforceable contract will therefore need to meet these requirements. Having said that, there is no mandatory form for contracts in Ireland generally (although a small number of contract types are subject to specific rules, e.g. contracts relating to the sale of land, or consumer credit agreements). Accordingly, whilst contracts relating to crypto-assets or which are based on distributed ledger technology **(DLT)** present potentially new and novel practical and legal issues, which may not neatly fit into the traditional models of contracts, the Irish common law provides significant flexibility to the courts to interpret the intentions of the parties and apply general principles of contract law to new situations.

2.3 Some of these issues are not entirely new. The concept of a smart legal contract (i.e. a computerised protocol that executes the terms of a contract), for example, has existed without issue in respect of vending machines; where the offer, acceptance, and execution are all automated once sufficient funds have been presented. Although the terms of newer smart contracts (based on DLT) may be more complex, the principles should however remain fundamentally the same.

2.4 The increase in consumer-focussed products and services based on DLT (e.g. decentralised finance **(DeFi)**) is also likely to give rise to a need for new legislation or protections. In particular, contracts with consumers could give rise to issues around intelligibility and/or plain English, where the contract is executed through a smart contract. Additional protections, such as pre-contractual information or summaries (e.g. a key information document for consumers), might be considered as a means to manage consumers' potential exposures. Consumer investment in or purchase of virtual currencies or crypto-assets, such as tokens issued by companies or non-fungible tokens **(NFTs)** also represent potential risks to consumers which may need to be addressed in future through appropriate legal and regulatory frameworks to protect consumers.

2.5 Separate to the treatment of crypto-assets, the emergence of so-called Decentralised Autonomous Organisations **(DAOs)** also gives rise to questions around the ability to contract and exposure to individual liability for members of DAOs. The nature of the initial fundraising, internal membership rights, and the associated tokenisation in respect of DAOs, also raise new and novel issues to be dealt with either by the courts or, ultimately, legislation. Some of these issues are discussed further in the smart legal contracts paper.

2.6 It is worth noting that if a crypto asset is deemed an uncertificated security, it may be subject to different rules and regulations for the registration and transfer of ownership compared to traditional certificated securities. Under Irish law, the Companies Act 2014 allows for uncertificated securities, but the relevant statutory instrument (the Companies Act, 1990 (Uncertificated Securities) Regulations 1996) only applies to specific categories of securities and does not explicitly mention digital/crypto assets. This may create uncertainty regarding the legal framework for the registration and transfer of ownership of such assets.

2.7 As only one of two remaining common law jurisdiction in the EU, Ireland provides a suitable base within the EU for businesses whose models depend on contracts, particularly complex ones. Further, as the use of such DLT-based contracts and the involvement of parties such as DAOs evolve, and becomes more complex, there will inevitably be an increase in disputes which should assist in providing additional clarity. The need for a supportive governing law and court system will therefore become ever more important.

3 JURISDICTION AND ENFORCEMENT

3.1 Another issue which may arise in relation to crypto-assets is where and how owners can enforce their rights vis-à-vis their assets. As digital/crypto assets often operate in a global and borderless environment, determining the jurisdiction and applicable regulations may be challenging. This can lead to potential issues with cross-border transactions and regulatory compliance, especially in cases where different jurisdictions have divergent approaches to classifying and regulating digital/crypto assets. There is no specific framework in Ireland dealing with the enforcement of crypto-assets. Instead, enforcement may depend on the jurisdiction of the contract and the nature of the rights attaching to the crypto-asset.

3.2 Similarly, there are no specific Irish rules in relation to the applicable law (and forum of disputes) of contracts involving crypto-assets. Participants in such contracts, or the holders of crypto-assets, may be located in different (potentially numerous) jurisdictions around the world, and subject to different (and potentially non-aligned, if not conflicting) legal frameworks. The governing law and jurisdiction, as well as the dispute mechanism to be used, will therefore be important factors for the enforcement of disputes involving crypto-assets. These are matters which are typically dealt with in contractual arrangements, whether traditional

signed or otherwise executed contracts (including by indicating agreement, such as click-wrap software licence agreements) or smart legal contracts. Ultimately, if a contract does not deal with certain essential attributes of the parties' arrangement it falls to the governing law, including the common law, to fill in the gaps. This reduces legal certainty and is best avoided with clear statements on the governing law and jurisdiction.

3.3 In choosing the jurisdiction and forum, consideration should be given to how disputes between the parties will be resolved. For example, will disputes need to be referred to the Irish courts, or could an arbitration or alternative dispute mechanism be used? In setting out the jurisdiction for disputes, a number of bases might also be used, for example relating jurisdiction to the owner, issuer, facilitator, crypto-asset service provider **(CASP)** or another third party.

3.4 Choice of law rules are fact and location specific. The classification of crypto-assets as property rights and the concept of possession of a crypto-asset may also complicate the analysis. The main issue which may arise in the area of crypto-assets is that it may be difficult to pinpoint a ledger's actual location or the location of the cryptocurrency software itself. In considering crypto-assets, the UK Jurisdiction Taskforce **(UKJT)** (which is considering UK legal issues relating to DLT, smart contracts and associated technologies), through a legal statement, considered the following facts / circumstances to be important factors in determining the relevant jurisdiction, namely whether:

i) any off-chain asset is located in the jurisdiction;
ii) there is any centralised control in the jurisdiction;
iii) a particular crypto-asset is controlled by a particular user in the jurisdiction; and
iv) the law applicable to the relevant transfer of title (i.e. the parties' choice of law).

3.5 As a matter of general law, parties to a contract are generally free to choose the applicable governing law, which can be applied in part or to the whole of the contract. The jurisdiction or conflict of laws rules in Ireland are common law rules and are subject to change with the evolution of case law. However, Ireland is a signatory to the Rome Convention 1980 on the Law Applicable to Contractual Obligations. The rules of the Convention apply to contractual obligations in any situation involving a choice between the laws of different countries. Regulation 593/2008 on the Law Applicable to Contractual Obligations **(Rome I)** also applies in Ireland.

3.6 Rome I states that a contract will be governed by the law chosen by the parties expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. However, where parties have not made a choice on the law of the contract, the jurisdiction will vary. For example, the law governing the contract for the sale of goods will be the law of the country where the service provider has their habitual residence. Separately, where a contract is a consumer contract then it will, with some exceptions, be considered to be governed by the jurisdiction where that consumer has their habitual residence. Additional specific jurisdictional rules, for example in relation to insolvency events, succession, or matrimonial property, can also apply in particular circumstances.

3.7 As a jurisdiction of choice, Ireland represents an attractive option; with an independent and sophisticated judiciary, and specific commercial court processes which may be available in certain cases. The Irish courts are also supportive of the arbitral process, where opted for, and are reluctant to intervene in matters which are subject to an arbitration clause. Section 5 of the Irish Arbitration Act 2010 gives force of law in Ireland to the UNCITRAL Model Law on International Commercial Arbitration, providing additional legal certainty where arbitration is chosen as a dispute mechanism.

3.8 Similarly, as an EU Member State, where judgements have already been made in other EU Member States in relation to crypto-assets, these can be recognised by Irish courts pursuant to the Brussels I Recast Regulation. Ireland is also a party to the Lugano Convention 2007. On 1 September 2023, EU Member States also became a party to the Hague Convention on the Recognition and Enforcement of Foreign Judgements in Civil or Commercial Matters, which deals with the cross-border enforcement of judgements in civil and commercial matters between third country contracting states. Accordingly, even where Ireland has not been chosen as the jurisdiction for contractual purposes, enforcement of rights under contracts subject to EEA Member State and certain third country laws should be readily enforceable.

3.9 It is worth noting, however, that the transfer of ownership for crypto-assets that are classified as financial instruments may be more complex than for traditional securities. Due to the decentralised nature of Blockchain technology, the transfer of ownership for crypto-assets typically occurs through the exchange of cryptographic keys on a distributed ledger. This process is not in line with the traditional registration and transfer mechanisms for securities under Irish law, which generally involve updating a company's register of members or working with a central securities depository **(CSD)**.

4 INSOLVENCY TREATMENT OF CRYPTO-ASSETS

4.1 The classification of a crypto-asset as a financial instrument under Irish law may have implications for the treatment of such assets in insolvency proceedings. The differences in treatment based on this categorisation can be summarised as follows:

- **Financial Instrument Classification:** If a crypto-asset is considered a financial instrument under Irish law, it would be subject to the rules and regulations applicable to financial instruments in insolvency proceedings. This may include provisions related to the rights and claims of creditors, the valuation of assets, and the distribution of assets among creditors.

- **Non-Financial Instrument Classification:** If a crypto-asset is not considered a financial instrument under Irish law, it may be treated as a general asset in insolvency proceedings. In this case, the asset would be subject to the general rules governing the treatment of assets in Irish insolvency law, including the priority of claims, the realisation of assets, and the distribution of proceeds.

- **Asset Valuation:** The classification of a crypto-asset as a financial instrument or not may impact the valuation methodology used in insolvency proceedings. Financial instruments may be subject to specific valuation rules, while general assets may be valued using different methods. The fluctuating value of digital/crypto assets may also pose challenges in accurately determining their value in insolvency proceedings.

- **Asset Tracing and Recovery:** If a crypto-asset is considered a financial instrument, there may be specific rules and procedures related to tracing and recovering such assets in insolvency proceedings. This may include provisions related to the identification, freezing, and seizure of assets held by custodians or intermediaries. On the other hand, if a digital/crypto asset is not considered a financial instrument, asset tracing and recovery may be subject to general rules applicable to other types of assets.

- **Distribution of Assets:** The classification of a crypto-asset as a financial instrument or not may affect the distribution of assets among creditors in insolvency proceedings. Financial instruments may be subject to specific distribution rules, including the priority of claims and the rights of secured and unsecured creditors. If a digital/crypto asset is not considered a financial instrument, the distribution of assets would be subject to the general rules governing the priority of claims and the rights of creditors in insolvency proceedings.

4.2 In summary, the classification of a crypto-asset as a financial instrument under Irish law may have implications for the treatment of such assets in insolvency proceedings. The differences in treatment based on this categorisation can impact asset valuation, tracing and recovery, and the distribution of assets among creditors. It is important for insolvency practitioners, creditors, and other stakeholders to understand the classification of crypto-assets and the potential implications under Irish insolvency law.

B REGULATORY TREATMENT OF CRYPTO-ASSETS

1 INTRODUCTION

1.1 Whilst some of the issues relating to the general legal treatment of crypto-assets have been set out in Part A, there are also many specific regulatory regimes which could potentially capture crypto-assets. This section of the paper seeks to explain the ways that crypto-assets are potentially caught under existing regulatory regimes in Ireland. In each case we have discussed the characteristics that may bring the assets into scope and provided examples of the types of crypto-assets which could be captured under each regulatory regime.

1.2 Whilst these are set out in more detail below, the following table provides a very high-level summary of the current general treatment of crypto-assets under Irish law, as well as the common reasons for inclusion or exclusion from the relevant regime, as appropriate.

Regulatory Regime	Generally In-scope?	Common reasons for exclusion / inclusion
E-money	No	No claim against the issuer
Payment services	No	Not funds
MiFID	Maybe	Not a financial instrument
Funds / Collective Investment Sceheme (CIS)	No	Not a collective investment scheme
AML/CFT	Yes	In connection with virtual asset service providers, and under the FTR (and the TFR not yet in force)
Crowdfunding, Lending and Credit Intermediation	Maybe	Not an ICO
MiCAR	Yes	Specific to crypto-assets (but not yet in force)

2 E-MONEY

2.1 The first, and maybe most obvious, question in respect of crypto-assets (particularly virtual currencies), is whether they would fall within the existing e-money regime. In Ireland e-money is governed by the European Communities (Electronic Money) Regulations 2011 **(EMR)**, which transposed the Electronic Money Directive (Directive 2009/110/EC) **(EMD)**. "Electronic money" under the EMR/ EMD is required to have the following characteristics, namely it must:

- Be electronically stored monetary value;
- Represent a claim against the issuer of the e-money;
- Be issued on the receipt of funds for the purpose of making payment transactions; and
- Be accepted by a person other than the issuer.

2.2 There are a number of specific exemptions under regulation 5 of the EMR, which will also need to be considered on a case-by-case basis, but will generally not be relevant for widely distributed crypto-assets. At a high level the exemptions allow the issuance of e-money which can only be used for limited purposes (e.g. with a particular merchant or for a limited range of goods or services), the so-called Limited Network Exemption, and where the e-money is used for payment transactions by a provider of electronic communications networks or services provided in addition to electronic communications services for a subscriber to the network or service (e.g. by a mobile phone provider), subject to certain monetary limits.

2.3 In order to issue e-money it will generally be necessary to be authorised as an e-money institution **(EMI)** by the Central Bank or competent authority in another Member State, or as another appropriately authorised person, in particular credit institutions (i.e. banks) and certain public bodies.

2.4 In terms of whether a particular asset would be "electronically stored", Recital 8 of the EMD notes that this concept captures electronic money whether it is held on a payment device in the electronic money holder's possession or stored remotely at a server and managed by the electronic money holder through a specific account for electronic money. That definition should be wide enough to avoid hampering technological innovation and to cover not only all the electronic money products available today in the market but also those products which could be developed in the future.

2.5 The definitions of both “funds” and “payment transactions” under the EMR are referable to the definitions contained in the European Union (Payment Services) Regulations 2018 **(PSR)**, which transposed the Payment Services Directive (Directive 2015/2366/EU) **(PSD2)**, which is considered further below. It is likely that certain cryptocurrencies would be able to meet the requirement to be electronically stored, issued on the receipt of funds for the purposes of payment transactions, and accepted by third parties.

2.6 However, pure cryptocurrencies, such as bitcoin, will not typically meet the criteria to be classified as electronic money, as they will not represent a claim on the issuer: there is no issuer who would be required to redeem for fiat currency. Some stablecoins may meet this criteria, but would need to be assessed on a case-by-case basis.

2.7 In the European Banking Authority **(EBA)** 2019 Report with advice for the European Commission **(EBA Report)**, the EBA noted that five competent authorities in the European Union reported cases in which proposals for business models entailed crypto-assets that would, in the opinion of those competent authorities, satisfy the definition of e-money. One example given in the EBA Report was where a company proposed to issue a token which was intended to be the means of payment in a payment network. The token would be issued on the receipt of fiat currency and would be pegged to the given currency (e.g. €1 to 1 token). The particular token could be redeemed at any time, with the actual payment on the network being the underlying claim against the company that issued the token, or the right to get the claim redeemed. On this basis the particular tokens were found to constitute e-money.

2.8 A second example involved a case where, in summary, upon receipt of funds a firm would create tokens representing the amount received by a donor. This token would then be deposited in the donor’s wallet, ready to be pledged to a specific charity or redeemed at par value. The tokens would only be released to the charity (via the use of ‘smart contracts’) once pre-agreed conditions were met by the charity and validated by an independent third party. The charity would then receive tokens that could be redeemed with the issuer, at par value upon request, effectively resulting in a fiat fund wire transfer to the charity via traditional payment rails.

2.9 In its proposal for MiCAR, which is discussed in more detail below, the European Commission noted that stablecoins whose value is backed by one single currency that is legal tender are close to the definition of e-money under the EMD. However, the proposal also indicates that regulating stablecoins solely under the EMD would require stablecoin issuers to comply with existing legislation that may not be fit for purpose. Thus, the European Commission concluded that creating a bespoke legislative regime for stablecoins and global stablecoins, in combination with their regulation under EMD, was the preferred regulatory approach, in order to avoid regulatory arbitrage between stablecoins that are indistinguishable from e-money and the treatment of e-money issued on a distributed ledger.

2.10 MiCAR therefore establishes a category of ‘electronic money tokens’ or ‘e-money tokens’, meaning a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a single fiat currency that is legal tender. E-money tokens are deemed to be electronic money under the EMD. Additionally, e-money tokens which reference a Union currency are deemed to be offered to the public in the Union.

2.11 Amongst other things, issuers of e-money tokens offered to the public in the EU will need to be authorised as a credit institution or an EMI and comply with the requirements under the EMD. The requirement to be authorised as a credit institution or EMI does not apply to e-money tokens issued to certain qualified investors or where the average outstanding amount of e-money tokens does not exceed €5million over a period of 12 months (subject to national thresholds). Issuers would be required to submit a white paper to the national competent authority (similar to the requirement to submit a prospectus for approval for the offering of securities to the public).

2.12 National competent authorities, such as the Central Bank, as well as the EBA, will regulate issuers of significant e-money tokens and additional obligations for issuers would apply. The EBA would classify e-money tokens as significant e-money tokens on the basis of, for example, the number of e-money token holders, the value of the e-money tokens or their market capitalisation, the number and value of transactions, size of the reserve of assets, significance of the issuers' cross-border activities and the interconnectedness with the financial system. It should be noted, however, that MiCAR does not apply to crypto-assets that qualify as electronic money under the EMRs, except where they also qualify as electronic money tokens under MiCAR.

3 PAYMENT SERVICES

3.1 Payment services in Ireland are regulated under the PSR, which look to regulate how "funds" are transferred. In particular, payment services under the PSR include the execution of payment transactions, issuing of payment instruments, and money remittance (i.e. the transfer of funds between parties without the creation of a payment account).

3.2 Importantly, the PSR only regulate payment services in respect of "funds", which are defined as "banknotes and coins, scriptural money or electronic money". Accordingly, transactions involving crypto-assets will not generally be captured unless the crypto-asset also qualifies as e-money under the EMR.

3.3 In the event that the crypto-asset did qualify as e-money then payment services in connection with it would be regulated under the PSR, and it will generally be necessary to be authorised as a payment institution (if not the issuer), an e-money institution, or a credit institution, authorised by the Central Bank, or another Member State competent authority. However, depending on the purpose of the transactions and/or the services being provided in connection with the e-money, it may be possible to qualify under one or more exemptions under the PSR. These exemptions would include, for example, where the e-money is utilised based on specific payment instruments that can be used only in a limited way within a limited network (the so-called "limited network exemption"), or where the services provided are of a purely technical nature, and the provider does not come into possession of the funds at any time (the so-called "technical service provider exemption").

3.4 In relation to payment services, it could also be possible for certain smart contracts to qualify as payment instruments. A payment instrument is defined as "a personalised device(s) and/ or set of procedures agreed between the payment service user and the payment service provider and used in order to initiate a payment order". The use of smart contracts and/or other constructs could therefore constitute such a set of agreed procedures which would initiate a payment order upon the occurrence of certain events, e.g. merchant request. A payment token, which initiates a payment transaction in fiat currency or e-money could also be a payment instrument,

depending on its precise characteristics. Ultimately case-by-case analysis is required to ascretain whether certain smart contracts that could be used to initiate a payment order in relation to funds could amount to a payment instrument under the PSR (please see smart legal contracts paper for further detail).

3.5 Separately to the requirements under the PSR, the Eurosystem oversight framework for electronic payments **(PISA)** establishes a set of oversight principles to assess the safety and efficiency of electronic payment instruments, schemes and arrangements. The PISA Framework covers general purpose electronic payment instruments (i.e. which are not limited, with regard to transfer of value, to a single type of payee or to specific uses), all variants thereof (such as instant and/or business-to-business versions) and the usage of electronic payment instruments to place or withdraw cash. As noted, a payment instrument is a personalised device (or a set of devices) and/or set of procedures agreed between the payment service user and the payment service provider used in order to initiate a transfer of value. Typical examples of electronic payment instruments are cards, credit transfers, direct debits, e-money transfers and digital payment tokens.

3.6 The term "transfer of value" is not linked to the PSD2 definition of "funds" and is therefore broader than banknotes and coins, scriptural money or electronic money. From a Eurosystem perspective recent technological developments warrant the extension of the scope of the PISA Framework to transfer of value. Transfer of value is defined by the ECB in its Glossary as:

> *"The act, initiated by the payer or on the payer's behalf or by the payee, of transferring funds or digital payment tokens, or placing or withdrawing cash on/from a user account, irrespective of any underlying obligations between the payer and the payee. The transfer can involve single or multiple payment service providers."*

3.7 The ECB defines digital payment tokens as:

- a digital representation of value;
- backed by:
  - claims or assets denominated in euro or redeemable in euro, or
  - referring to other digital assets that are accepted under the rules of an electronic payment instrument scheme for payment purposes, or
  - to discharge payment obligations in euro; and
- which enables the transfer of value between end users.

3.8 Depending on the underlying design, digital payment tokens can be used to effect a transfer of value without necessarily involving a central third party and/or using payment accounts. The term digital payment token excludes the "tokenisation" of sensitive data by a surrogate value which is conducted for security reasons to protect the original data and where the token does not represent an asset or claim recorded elsewhere.

3.9 This would capture certain crypto-assets used within a scheme and certain stablecoins (e.g. stablecoins used to discharge payment obligations in euro within a scheme), alongside already overseen payment schemes of other payment instruments. As the focus is on digital payment tokens, it is anticipated that utility tokens (i.e. tokens which can be used to obtain services) should not be within scope, and PISA expressly excludes services where the transfer of value has only an investment focus.

3.10 From a geographic perspective, the PISA Framework covers an electronic payment instrument if:

i) it enables a transfer of value to/from end users within the euro area, or
ii) if the transfer of value is based on electronic payment instruments denominated in or funded in euro, partly or fully backed by euro, or redeemable in euro (regardless of where the end user is located).

3.11 Every three years, the ECB coordinates a Eurosystem-wide exercise to identify schemes/arrangements which fall within the scope of the PISA Framework. The ECB maintains and publishes a list of all payment schemes/arrangements subject to Eurosystem oversight under the PISA Framework on its website specifying the respective lead overseer for each scheme/arrangement. The present Eurosystem exemption policy complements the PISA framework. The policy defines the criteria used to identify the schemes/arrangements to be overseen by the Eurosystem and those which are to be monitored or are exempt, taking into account their relevance for the overall payment system. Schemes/arrangements that are already overseen according to the 'Harmonised oversight approach and oversight standards for payment instruments', remain under oversight until they are informed about the outcome of their assessment against the exemption criteria and should prepare to adhere to the PISA framework.

3.12 The Eurosystem applies a points system to assess a scheme/arrangement against the following four criteria:

i) The size of the end user or payment service provider base;
ii) The degree of market penetration in terms of volume;
iii) The degree of market penetration in terms of value; and
iv) Geographic relevance.

3.13 The first two criteria differentiate in their scoring between pan-European and national schemes/arrangements. A scheme/arrangement is considered to be pan-European if it provides services to end users or payment service providers in five or more-euro area countries. In each case, the lead overseer takes the potential risks into account and reports the decision to the ECB's Governing Council, the European System of Central Banks **(ESCB)** Market Infrastructure and Payments Committee **(MIPC)**. The national central bank of the country where the scheme/arrangement is located may carry out such monitoring. Ultimately the PISA Framework is directed at the governance of schemes and arrangements, and covers digital payment tokens together with existing payment schemes.

4 FINANCIAL INSTRUMENTS AND INVESTMENT SERVICES

4.1 In Ireland, the provision of investment services is governed by the European Union (Markets in Financial Instruments) Regulations 2017 **(MiFID Regulations)**, which transpose Directive 2014/65/EU **(MiFID II)**, together with associated EU Regulations and implementing secondary legislation. At a high level, in order to be captured by the MiFID Regulations it will be necessary to be carrying on investment services (including the receipt and transmission of orders, execution of orders, portfolio management, the provision of investment advice, placing or underwriting services, or dealing on own account) in respect of 'financial instruments'. The operation of regulated markets, multilateral trading facilities **(MTF)** and organised trading facilities **(OTF)** in respect of financial instruments will also be captured. Accordingly, if a crypto-asset does constitute a financial instrument then service providers and market / platform operators are likely to require authorisation under the MiFID Regulations. The conditions and criteria for crypto-assets to qualify as "financial instruments" under MiFID was recently considered in the ESMA Consultation Paper.

4.2 The MiFID Regulations provide a list of financial instruments in Part 3 of Schedule 1 of the MiFID Regulations, and includes:

- Transferrable securities;
- Money market instruments;
- Units in collective investment undertakings;
- Certain derivative contracts (including options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities and commodities).

4.3 In respect of crypto-assets, from a MiFID perspective, the key determinant of whether it is potentially caught by the MiFID Regulations will be whether the asset is constituted in such a way that it could constitute a "financial instrument". If it does, then activities such as the execution of orders, or otherwise facilitating transactions in these instruments, would be captured under the MiFID Regulations. However, for the avoidance of doubt, if the crypto-asset would not constitute a "financial instrument", the fact that investment services could (nominally) be being carried out in respect of them, would not affect the analysis. Some non-exhaustive practical examples of types of assets which may, following case-by-case examination, be classified as financial instruments pursuant to Part 3 of Schedule 1 of the MiFID Regulations include:

i) **Security Tokens:** If a digital or crypto asset represents an ownership interest in an underlying asset or company, it could be classified as a 'transferable security' under MiFID II. Security tokens often grant holders rights such as dividends, profit sharing, or voting rights. In this case, the token would be considered a financial instrument under Irish law.

ii) **Utility Tokens with Derivative-like Features:** Some utility tokens, which are designed to grant holders access to a product or service, may have derivative-like features. For example, if a utility token's value is linked to an underlying financial index or asset, such as a currency or commodity, it might fall under the category of a derivative contract, thus meeting the definition of a financial instrument.

iii) **Asset-backed Stablecoins:** Stablecoins are digital assets designed to maintain a stable value by pegging them to a reserve of assets, such as fiat currencies, commodities, or other cryptocurrencies. If the stablecoin's value is linked to a financial instrument like a security, currency, or commodity, it could potentially be considered a financial instrument itself.

iv) **Decentralised Finance (DeFi) Tokens:** DeFi tokens are digital assets used within decentralised financial platforms, which may facilitate various financial services, such as lending, borrowing, and trading. Depending on the specific characteristics and functions of a DeFi token, it might be considered a financial instrument if it exhibits features similar to those of a derivative, security, or other financial instrument categories outlined in MiFID II.

4.4 It should be noted that whilst MiCAR introduces a regime for crypto-assets along similar lines as MiFID, crypto-assets which fall within MiFID will continue to be governed by MiFID, rather than MiCAR.

Transferrable Securities

4.5 The first specific category of financial instrument to consider is transferable securities. These are defined as:

> *"[T]hose classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:*
>
> *(a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares,*
> *(b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities, or*
> *(c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures…"*

4.6 The reference in the definition to "negotiable on the capital market" in effect means that the relevant instrument can be bought or sold / is transferable or tradable on the markets. The European Commission has issued guidance confirming that "negotiable on the capital market" is to be interpreted broadly, and does limit itself to securities listed or traded on regulated markets. The ESMA Consultation Paper notes in this regard that what constitutes a "capital market" should be interpreted broadly and will including venues where securities are traded as well as over-the-counter markets:

> *"If a crypto-asset can be traded on such trading platforms or other electronic and/or voice trading platforms where buying and setting interest in securities meet, the capital market criterion should be met."*

4.7 Further, the ESMA Consultation Paper notes that the criterion of negotiability implies that the crypto-asset must be transferable or tradable on markets, even if certain legal, market or technical restrictions may apply. Although there is some divergence between Member State's interpretation the concept should be interpreted broadly. Further, the Consultation Paper notes that "[n] egotiability on capital market also presupposes fungibility which has to be measured having regard to the capability of the crypto-asset to express the same value per unit".

4.8 Ultimately, whilst it would in principle be possible to limit the transferability of certain crypto-assets, in practice transferability is likely to be an inherent characteristic of the relevant crypto-asset, as their value is likely to derive significantly from their transferability.

4.9 However, crypto-assets will not generally, on their face, be in the form of shares, bonds, or other traditional instruments. The question therefore arises as to whether they may still have the characteristics of such securities.

4.10 MiFID does not define the term "securities", but this phrase can be understood to mean instruments akin to traditional instruments like shares or debentures, which give rise to particular ownership or economic rights in the issuer. As discussed in relation to e-money, crypto-assets will not generally give rise to ownership or other economic rights or claims against the issuer. Whilst, conceptually, it may be possible for a crypto-asset to be constructed to provide such rights, in practice this is unlikely (and indeed it is likely that the crypto-asset will be deliberately constructed to avoid such categorisation).

4.11 The ESMA Consultation Paper notes that in order for a crypto-asset to constitute a class of securities:

> *"[T]hey should confer similar rights to investors, ensuring their tradability on markets. Any crypto-asset class representing an abstract category of securities… e.g. an ownership in a company, conferring rights akin to shares, embodying bonds or other forms of securitised debt, or embedding a derivative should be considered under the ambit of securities. In order to form a class, crypto-assets are generally viewed as (i) interchangeable, (ii) issued by the same issuers, (iii) having similarities, and (iv) providing access to equal rights."*

4.12 Thus, for example, whilst initial coin offerings **(ICOs)** may appear similar to an initial public offerings of securities in terms of their aim (i.e. to assist companies with raising capital and liquidity), the tokens issued as part of the ICO generally lack ownership or economic rights associated them (beyond simple ownership of the token, and the intrinsic value associated with it). Accordingly, such tokens are unlikely to be securities. Similarly, although NFTs may be transferrable and negotiable on the capital markets, they do not give a holder rights against the issuer; just the right to ownership of the relevant NFT.

4.13 It should be noted that if a crypto-asset constituted a security and was being offered to the public, additional considerations under the Prospectus Regulation (Regulation 2017/1129/EU) would also apply. Further review is outside of the scope of this paper.

4.14 Ultimately, according to the ESMA Consultation Paper, for a crypto-asset to be recognised as a transferable security under MiFID it will need to be "negotiable, transferable, and encapsulate rights attached to securities … [and] should be assessed on a case-by-case basis by [National Competent Authorities."

Money Market Instruments

4.15 A "money market instrument" is defined under the MiFID Regulations as:

> *"those classes of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers and excluding instruments of payment…"*

4.16 The purpose of the money market is to allow financial institutions and certain large corporates to access short-term funding. Money market instruments are therefore primarily a form of short-term credit (or similar financing). The ESMA Consultation Papers notes that in order for a crypto-asset to be classified as a money-market instrument it must exhibit characteristics akin to traditional money-market instruments, namely:

> *"(i) having a legal and residual maturity as required for in the Money Market funds regulation (MMFR), (ii) exhibiting stable value and minimal volatility, and (iii) aligning returns with short-term interest rates. … Therefore, a crypto-asset should operate within the money market and embodies characteristics akin to treasury bills, certificates of deposit, and commercial papers. The crypto-asset should serve as a representation of a credit balance, either resulting from funds retained in an account or from temporary situations*

stemming from standard banking transactions, which a financial institution is obligated to repay as per Directive 2014/49/EU [the Deposit Guarantees Scheme Directive]. … A crypto-asset that would function as a representation of a short-term debt commitment issued and endorsed by a government, should also be classified as a money market instrument. Same should apply for a crypto-asset that presents a short-term negotiable debt obligation issued by either a bank or a corporation within the international money market to garner funds."

4.17 Accordingly, whilst it is currently unlikely that a crypto-asset would constitute a money market instrument, in principle it would be possible to construct a crypto-asset meeting the definition of a money market instrument. For example, it would be possible to tokenise short-term funding arrangements between financial institutions and, depending on the precise terms, these could constitute money market instruments.

Units in collective investment undertakings

4.18 A "collective investment undertaking" is not defined under MiFID, but has been the subject of Guidance from ESMA in the context of AIFMD. In particular, ESMA has clarified that the following characteristics, if all of them are present, would demonstrate that an undertaking is a collective investment undertaking:

"(a) the undertaking does not have a general commercial or industrial purpose;

(b) the undertaking pools together capital raised from its investors for the purpose of investment with a view to generating a pooled return for those investors; and

(c) the unitholders or shareholders of the undertaking – as a collective group – have no day-to-day discretion or control. The fact that one or more but not all of the aforementioned unitholders or shareholders are granted day-to-day discretion or control should not be taken to show that the undertaking is not a collective investment undertaking."

4.19 The ESMA Consultation Paper notes that in order to constitute units in a collective investment scheme:

"Primarily, the crypto-asset should encapsulate capital raised from a number of investors for the purpose of investment with a view to generate a pooled return for the benefit of those investors. This could manifest in the form of crypto-assets that represent an investor's stake in the pooled capital."

4.20 Having regard to these characteristics, it is therefore generally unlikely that a crypto-asset will be constituted as a collective investment undertaking. Further, even where some of these characteristics are present, units / tokens in the relevant assets will not generally represent a collective investment by the purchasers of the asset. In the event that the particular crypto-asset did constitute a collective investment undertaking, in addition to investment services provided in respect of these services being captured by the MiFID Regulations, they may also be captured by the relevant funds legislation (particularly AIFMD), and this is discussed further below.

Derivatives

4.21 The list of financial instruments includes a number of types of derivative which may be captured as financial instruments. Taken at a high level, a derivative will be any instrument which derives its value by references to another share, interest rate, foreign exchange rate, commodity, or other similar reference rate. Whilst it will generally be clear if a crypto-asset's value is derived from one of more of these sources (e.g. if derived its value from the share price of a company), it might be asked whether a derivative based on another crypto-asset would be captured. The ESMA Consultation Paper supports the notion that a crypto-asset would be an "asset" in this regard for the purposes of MiFID. Whilst a complete analysis of the characteristics of derivatives under MiFID is beyond the scope of this paper, it is therefore clear that crypto-assets could constitute derivatives, at least in principle.

4.22 The MiFID Regulations set out the following general types of derivative which are captured as financial instruments, namely:

- derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;
- derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event;
- derivative contracts relating to commodities that can be physically settled provided that they are traded on a regulated market, an MTF, or an OTF;
- other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in the preceding category, and not being for commercial purposes, which have the characteristics of other derivative financial instruments;
- derivative instruments for the transfer of credit risk;
- financial contracts for difference;
- Derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event, as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, MTF or OTF.

4.23 The final category of derivatives set out above (and at point (10) in Part 4 of Schedule 1 of the MiFID Regulations) is however cast extremely broadly. Conceptually, therefore, it may be possible that a derivative derived from another crypto-asset could be captured by this general category. Commission Delegated Regulation (EU) 2017/565, which provides guidance on the definition of derivatives under MiFID II, provides guidance on the nature and extent of the derivatives in point (10), noting, inter alia, that this category would also include derivatives relating to:

- any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred;
- an index or measure related to the price or value of, or volume of transactions in any asset, right, service or obligation;
- an index or measure based on actuarial statistics.

4.24 Considering the broad categories of derivatives under MiFID, the ESMA Consultation Paper notes that:

> *"[D]erivative contracts encompass a broad range of financial contracts, including options, futures, swaps, and forward contracts. These contracts derive their value from an underlying asset, variable, rate, index, instrument or commodity. To categorise a crypt-asset as a derivative, it needs to meet specific essential characteristics outlined in MiFID II. ... Primarily, a crypto-asset to be possibly qualified as a financial derivative under MiFID II should be the 'digital representation' of a contract. In addition, a derivative crypto-asset should have any underlying reference, which determines its value. This reference … could be for example an asset, a rate, an instrument or a commodity."*

4.25 There would therefore be a risk that if, for example, the crypto-asset's value was derived from multiple public sources, such as details of trading in various venues or assets, this could fall within this general catch-all, as an index based on the volume of transaction in any asset.

4.26 It should be noted that in order to be captured, the relevant instrument would also need to meet the prerequisites set out in Article 7(3) of the Commission Delegated Regulation (EU) 2017/565, which include that that the derivative must be one of the following:

- settled in cash, or could be settled in cash at the option of one or more of the parties, otherwise than by reason of a default or other termination event;
- traded on a regulated market, an MTF, an OTF, or a third country trading venue that performs a similar function to a regulated market, MTF or an OTF; or
- the conditions laid down in Article 7(1) are satisfied in relation to that contract (in essence that the contract is not a spot contract).

4.27 The ESMA Consultation Paper also notes the settlement requirements, but acknowledges that in respect of the cash settlement criterion this point is still under consideration by EMSA. In particular:

> *"Whilst the notion of 'cash' is neither defined by MiFID II nor within [the Commission Delegated Regulation], the notion is covered by Regulation 2018/1672/EU [on controls on cash entering or leaving the Union] which refers to currency, bearer-negotiable instruments, commodities used as highly-liquid stores of value and prepaid cards. This raises the question of crypto-asset bearing rights similar to derivatives, but which would be settled in crypto-assets, EMTs or ARTs instead of cash."*

4.28 Ultimately, the precise nature of the relevant crypto-asset would need to be assessed to determine whether it constitutes a derivative. If this is the case there would be a number of ancillary requirements which would apply by virtue of being a derivative, for example the need for to potentially comply with the European Market Infrastructure Regulation **(EMIR)**, in addition to the application of the MiFID Regulations.

Investment Business Services

4.29 In addition to the MiFID Regulations, it should be noted that there is also additional local legislation which will capture certain services carried out in respect of "investment instruments" under the Investment Intermediaries Act 1995 **(IIA)**. Where a service is already covered by the MiFID Regulations it is generally accepted that the IIA will not apply. The definition of "investment instruments" under the IIA is also essentially analogous to the definition of "financial instruments" under the MiFID Regulations. Accordingly, where a firm is provided any of the investment services under the MiFID Regulations in respect of "investment instruments" under the IIA, only the MiFID Regulations would apply. As a piece of national legislation, however, authorisation as an investment business firm under the IIA does not provide passporting rights to allow firms to provide such services on a cross-border basis within the EEA.

4.30 It should be noted, however, that the MiFID Regulations include certain services which constitute "ancillary services". It is not necessary to obtain authorisation under the MiFID Regulations where these are provided on a standalone basis. However, where these activities also constitute an "investment business service" under the IIA, authorisation as an investment business firm would be required. In particular, and most pertinently, this includes the safekeeping and administration / custody of financial instruments. Accordingly, if a crypto-asset was a financial instrument under the MiFID Regulations, the custodian of those instruments (assuming they are not carrying out any other investment services in respect of those instruments under the MiFID Regulations) could require authorisation as an investment business firm under the IIA. Where custodian wallet services are also being provided in respect of a crypto-asset, registration as a VASP may be required.

5 FUNDS

5.1 Ireland is an established fund hub in the EU and globally, with a well-developed industry including funds, fund service providers, and specialist supports (including legal and accounting). Ireland is therefore likely to be at the forefront of the treatment of crypto-assets in the context of funds, whether through the inclusion or exposure to crypt-assets or the use of DLT to facilitate novel fund structures or execution models, as we have already seen the Central Bank approve certain non-retail funds with exposures to crypto-assets.

5.2 The cornerstone pieces of funds legislation in Ireland are the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (as amended) **(UCITS Regulations)** and the European Union (Alternative Investment Fund Managers) Regulations 2013 (as amended) **(AIFM Regulations)**, which implement Directive 2009/65/EC **(UCITSD)** and Directive 2011/61/EU **(AIFMD)** into Irish law, respectively. The Central Bank is the regulatory authority in Ireland that is responsible for the authorisation and ongoing supervision of undertakings for the collective investment in transferable securities **(UCITS)** under the UCITS Regulations and alternative investment funds **(AIFs)** under the AIFM Regulations.

5.3 A UCITS is a diversified, limited leverage, open ended investment fund that has as its sole object the collective investment of capital raised from the public in transferable securities or other liquid financial assets, and which operates on the principle of risk-spreading. An AIF is generally an investment fund that is not a UCITS and in Ireland includes retail investor alternative investment funds **(RIAIFs)** and qualifying investor alternative investment funds (**QIAIFs**, and together with RIAIFs and UCITS, Funds).

5.4 As discussed, in terms of the categorisation of crypto-assets as "financial instruments" under MiFID, it is generally unlikely that a crypto-asset will be constituted as a fund / collective investment scheme, as units / tokens in the relevant assets will not generally represent a collective investment. This is not, however, to say that it would not be possible to issue crypto-assets which could fall within these general definitions. As such, consideration would still need to be given to whether authorisation would be required as a UCITS, or more likely an AIF. In the event the relevant asset did constitute a regulated fund it would then be necessary to appoint a fund manager and comply with UCITS Regulations or AIFM Regulations, as appropriate.

5.5 A separate consideration is whether existing UCITS and AIFs could invest in, or otherwise gain exposure to, crypto-assets, and if so what restrictions or preconditions would apply.

Investment by UCITS Funds in Crypto-assets

5.6 Whether a UCITS may indirectly or directly invest in crypto-assets typically depends on whether the crypto-asset or the financial instrument under consideration is an eligible asset pursuant to the UCITS Regulations. Such an analysis is somewhat moot, however, as the Central Bank has confirmed (for now) that an indirect or direct exposure of a UCITS to crypto-assets would typically not be appropriate given that in its view retail investors would "not be able to appropriately assess the risks of making an investment in a fund which gives such exposures". Thus, promoters looking to establish a Fund in Ireland with an investment policy directed at crypto-assets may find the QIAIF wrapper more appropriate for such a strategy.

5.7 Eligible assets for the purposes of the UCITS Regulations comprise transferable securities, such as shares in companies and other securities equivalent to shares in companies, bonds and other forms of securitised debt, and any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange, provided that such assets are admitted to or dealt in on a regulated market. Although some crypto-assets that constitute security tokens may qualify as a transferable security, very few of those crypto-assets will be admitted to or dealt in on a regulated market, thus making them ineligible for investment by a UCITS.

5.8 A UCITS may however also invest up to 10% of its assets in transferable securities or money market instruments that do not trade on a regulated market. A UCITS may also invest in other collective investment schemes. On that basis, a UCITS may be able to achieve direct exposure to crypto-assets that constitute transferable securities or money market instruments that do not trade on a regulated market and indirect exposure to crypto-assets by investing in the shares or units issued by other collective investment schemes that themselves invest in crypto-assets.

5.9 Although it may be possible for a UCITS to gain exposures to crypto-assets in theory, either directly or indirectly, where they can meet the criteria to qualify as eligible assets (e.g. if they constituted transferable securities admitted to a regulated market), this is currently unlikely in practice. Indeed, the Central Bank's position was set out in the 36th edition of the UCITS Questions and Answers **(UCITS Q&A)**. In respect of crypto-assets that are "based on an intangible or non-traditional underlying", the Central Bank noted that:

> *"[I]t has not seen information which would satisfy it that crypto-assets are capable of meeting the eligible asset criteria for UCITS… [and is not satisfied that] indirect exposure to crypto-assets is capable of being appropriately risk managed … [Crypto-assets] present significant risks,*

> *including liquidity risk; credit risk; market risk; operational risk (including fraud and cyber risks); money laundering / terrorist financing risk; and legal and reputation risks".*

Given those risks, in the Central Bank's view:

> *"[R]etail investors will not be able to appropriately assess the risks of making an investment in a fund which gives such exposures … [and accordingly the Central Bank is] highly unlikely to approve a UCITS proposing any exposure (either direct or indirect) to crypto-assets".*

5.10 Whilst this is the current position, having regard to the nature and type of crypto-assets currently in the market, the Central Bank has acknowledged that its approach in relation to crypto-assets will be kept under review. European regulatory discussions on the topic will naturally inform the Central Bank's position and approach, and should new information or developments emerge in the future it may be that certain crypto-assets providing either direct or indirect exposures could qualify as eligible investments for UCITS in the future.

Investment by AIFs Funds in Crypto-assets

5.11 Unlike a UCITS, whether an AIF established and authorised in Ireland (i.e. a RIAIF or QIAIF) may indirectly or directly invest in crypto-assets does not depend on any eligible asset criteria. The AIFM Regulations do not generally provide a mandatory list of eligible assets that an AIF must invest in. Although the Central Bank has set out certain rules applicable to QIAIFs and RIAIFs in its rulebook (the **AIF Rulebook**), those rules are in general less restrictive than the eligible assets requirements imposed on a UCITS, especially with respect to QIAIFs (where there are generally no restrictions on the type of assets in which a QIAIF may invest). Thus, in theory, an AIF may be able to invest, directly indirectly, in crypto-assets.

5.12 Whether a QIAIF or RIAIF may be authorised by the Central Bank to gain indirect or direct exposure to crypto-assets is therefore likely to depend on whether the requirements imposed on the investment fund manager **(AIFM)** and the depositary under the AIFM Regulations can be complied with. In particular, amongst other requirements, consideration will need to be given to risk management, valuation and custody requirements.

5.13 Limited commentary from the Central Bank and ESMA assist in informing the approach to the requirements in Ireland, although for the moment it remains unsettled. In summary, the Central Bank has stated that it generally will be highly unlikely to favour a RIAIF proposing any exposure (either direct or indirect) to crypto assets. In the case of a QIAIF seeking to gain exposure to crypto-assets, the relevant QIAIF would need to make a submission to the Central Bank outlining how the risks associated with such exposures could be managed effectively by the AIFM. The Central Bank may authorise indirect or direct exposure to crypto-assets for a QIAIF provided that the requirements of the AIFM Regulations can be complied with. The Central Bank's recent authorisation of low levels of indirect exposure to cash-settled future contracts that reference an underlying crypto-asset for two QIAIFs demonstrates the Central Bank's willingness to consider applications for authorisation of QIAIFs that seek to gain indirect exposure to crypto-assets.

5.14 The Central Bank also has Pre-submission Requirement for Promoters of AIFs pursuing an investment strategy of indirect or direct exposure to crypto-assets. As noted, the Central Bank's position (set out in its AIFMD Questions & Answers **(Central Bank AIFMD Q&A)**), is that exposures to crypto-assets

are highly unlikely to be suitable for RIAIFs. As for UCITS, in the Central Bank's view, "retail investors will not be able to appropriately assess the risks of making an investment in a fund which gives such exposures", and accordingly their inclusion in RIAIFs is unlikely to be appropriate.

5.15 In relation to QIAIFs, the Central Bank may permit a QIAIF to invest indirectly in digital assets. However, this is subject to certain prerequisites, including:

- Demonstrating that a depository can meet its obligations under AIFMD to provide custody or safe-keeping services in relation to crypto-assets;
- Having an effective risk management policy to address the associated risks, which incorporates at a minimum risks relating to "liquidity, credit, market, custody, operational, exchange risk, money laundering, legal, reputational and cyber risk";
- The AIFM carrying out appropriate stress testing, including around asset price volatility assuming an extreme yet plausible scenario (including the potential loss of the entire investment);
- Having an effective liquidity management policy in place;
- Clear prospectus disclosures on the nature of the investment the risks associated with it;
- Assessing the overall portfolio "to ensure that there is an alignment between the redemption profile, the level of investment in digital assets and the likelihood of illiquidity (both in normal and stressed conditions) in the types of digital assets invested in".

5.16 The Central Bank has stated that a QIAIF seeking exposure to crypto-assets must make a submission to the Central Bank demonstrating that the fund manager of the QIAIF (i.e. the AIFM) can effectively manage the risks posed by crypto-assets. The Central Bank has therefore imposed a relatively high threshold on AIFMs to demonstrate that they have effective policies, procedures, and tools to effectively manage the risks that derive from an investment in crypto-assets. Accordingly, a robust risk framework, targeting the specific risks associated with crypto-assets, will be necessary for a QIAIF that seeks to gain indirect or direct exposure to crypto-assets.

5.17 The AIFMD Q&A notes that crypto-assets typically present significant liquidity, credit, market, operational, fraud, cyber, money laundering, terrorist financing, legal, and reputational risks. Nevertheless, the Central Bank has approved low levels of indirect exposure to cash settled bitcoin futures trading on the Chicago Mercantile Exchange. Thus, approval for indirect exposures to crypto-assets for a QIAIF is certainly possible; albeit only low levels of indirect exposure to crypto-assets have so far been approved.

5.18 Similar to UCITS, the Central Bank has stated that its approach in relation to AIFs will be kept under review and may change as new information or developments in the crypto-asset sector arise, or in light of developments at an EU level. The introduction of MiCAR may also influence the Central Bank's position, as this is likely to feed into the assessment of the ability of the funds to manage some of the risks associated with these assets, with more regulated services providers and supervisory oversight of parts of the sector.

5.19 Apart from questions around investments in crypto-assets, in the event than an AIF does invest in crypto-assets there are likely to be a number of additional areas, both operational and regulatory (which are subject matters beyond the scope of this paper), that will require greater consideration including risk management, valuation, custody, depository duties, and delegation, amongst others. Whilst certainly presenting additional complexity, it is likely that, in time, many of the current challenges and uncertainties will be mitigated as more funds seeking some level of exposure to crypto-assets seek approval from the Central Bank. With a number of funds with crypto-asset exposures already

approved, Ireland should be able to continue to position itself as a leading funds jurisdiction into the future.

6 MONEY LAUNDERING AND TERRORIST FINANCING

6.1 Despite the element of transparency that Blockchain technology affords to crypto-asset transactions, the fact that crypto-assets can be transmitted in a quick, cross-border and increasingly anonymous manner, makes them an ideal vehicle for money laundering and terrorist financing purposes. Their irreversibility also presents challenges for recoverability, where funds are been transmitted to anonymous recipients, likely outside of the EEA.

6.2 Whilst to some these elements of crypto-transactions are a core part of their purpose and utility, the inherent AML/CFT risks associated with crypto-transactions were quickly identified as a potential issue by national and international regulators and governments. In 2014, the Financial Action Task Force **(FATF)** noted that a great amount of AML/CFT risk associated with crypto-transactions is attributable to their anonymous nature. In the case of Bitcoin for example, user addresses have very little customer identification attached, and the Bitcoin protocol does not mandate prior participant verification, nor the ongoing monitoring and identification of suspicious transaction patterns.

6.3 Since 2014, the crypto market has become increasingly global and complex, leading to segmentation of services, which in turn create uncertainty with regard to the allocation of responsibility for AML/CFT compliance and supervision. More recently, the Financial Stability Institute of the Bank of International Settlements **(BIS)** reiterated the AML/CFT risks which are inherent in decentralised applications **(dApps)** and crypto transactions over distributed ledgers, and added that numerous cryptocurrencies and service providers integrate technology designed to reduce transparency, such as "cryptocurrency tumbler", "crypto mixing services", or "anonymity-enhanced coins" **(AECs)**, which aim to fuse funds in order to make them less identifiable.

6.4 Some level of regulatory oversight was therefore inevitable. As an initial step, the Fifth Money Laundering Directive EU/2018/843 **(5MLD)** sought to bring exchange services providers and custodian wallet providers within the scope of the AML/CFT requirements generally applicable to other financial service providers, to mitigate against the use of these service providers being used by criminals to launder money, or transfer it internationally, as well as fund terrorist organisations, or evade financial sanctions.

Virtual Asset Service Providers (VASPs)

6.5 The Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Act 2021, amended the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 **("AML Act")**, to transpose provisions of 5MLD into Irish law (becoming effective on 23 April 2021). This included the designation of VASPs as "designated persons" under the AML Act.

6.6 This made these entities subject to the AML requirements under the AML Act, including customer due diligence **(CDD)** requirements, reporting obligations, beneficial ownership information, and record retention obligations. VASPs caught by the requirements will include providers of the following services:

- Exchange between virtual assets and fiat currencies;
- Exchange between one or more forms of virtual assets;
- Transfer of virtual assets;
- Custodian wallets; or
- Participation in, and provision of, financial services related to an issuer's offer or sale of a virtual asset or both.

6.7 For the purposes The VASP registration under the AML Act will

be superseded by the CASP authorisation under MiCAR. From the 30 December 2024, all new CASPs will need to obtain authorisation under MiCAR. At the time of writing (September 2024), the Central Bank has already indicated that new VASP registration applications will not accepted, and has asked that all new applications instead be made under MiCAR. For existing VASPs, they will also need to apply for authorisation under MiCAR, but are provided with a transitional period of 12 months from 1 January 2025 within which to obtain authorisation.

6.8 Authorisation under MiCAR is likely to require a substantive uplift in terms of resources, internal governance, policies and procedures, and therefore all firms wishing to provide / continue providing crypto-asset services from 30 December 2024 should therefore be actively preparing their submissions for authorisation for submission to the Central Bank.

Funds Transfer Regulation

6.9 As part of the EU's AML/CFT Package, and in light of FATF's Recommendation 16 on wire transfers and Recommendation 15 on virtual / cypto-assets, Regulation 2015/847/EU (the Funds Transfer Regulation **(FTR)**) has been revised. The FTR requires payment service providers to collect certain information on the payer and payee and ensure that these follow the relevant funds transfer; seeking to ensure traceability of payment transactions. The Recast FTR came into force on 29 June 2023 and will apply from 30 December 2024 (also date of application MiCAR). It applies similar rules to funds transfers involving crypto-assets to mitigate some of the AML/CFT risks associated with crypto-transactions.

6.10 In summary, the new requirements will apply to crypto-asset transfers and CASPs and will cover any transactions at least partially carried out by electronic means through a CASP, where the CASP of the originator or the beneficiary is established in the EU. Person-to-person transfers carried out between natural persons acting outside of their business, trade, or profession (i.e. personal consumers) are however expressly excluded. CASPs are obliged to collect, verify and submit certain information about the originator (i.e. a person that holds a crypto-asset account or address) and the beneficiary (i.e. a person that is the intended recipient of the transfer of crypto-asset.

6.11 A service provider is required to record information such as the name, address, date of birth and account number of the customer it is carrying out the transfer on behalf of, as well as the name of the intended recipient of the transfer. The service provider of the beneficiary must also implement effective procedures, including, where appropriate, ex-post monitoring or real-time monitoring, in order to detect whether the required information on the originator or the beneficiary is missing.

6.12 The obligation to check whether information on the originator and beneficiary is accurate is only imposed in respect of crypto-asset transfers that exceed €1,000, unless the transfer appears to be linked to other transfers of crypto-assets.

Practical Considerations when Addressing AML Risks

6.13 Despite the growing AML framework for the crypto market, market participants still encounter some elements of uncertainty when developing or reviewing their AML/CFT strategy and framework.

6.14 Firstly, applying the so-called 'traditional' AML rules to projects based on decentralised protocols can prove to cause difficulties to some market participants. Indeed, in 2016, the International Monetary Fund (the **IMF**) declared that cryptocurrencies "pose considerable risks as potential vehicles

for money laundering, terrorist financing, tax evasion and fraud". At the same time there was also challenges involved in applying classic preventative measures to crypto payments on a decentralised platform, for example in relation to CDD requirements, record keeping, transaction monitoring, and lodging of suspicious transaction reports **(STRs)**. The IMF did not go into much detail regarding the nature of these challenges, yet it is clear that the very features that make the crypto market desirable, such as the absence of an intermediary, anonymity/privacy, and faster transactions, can cause uncertainty for owners of such decentralised projects to abide by their AML requirements in an effective and efficient manner.

6.15 Notwithstanding the acknowledgement of the complexity of cryptocurrencies, 5MLD provides very little guidance regarding how to apply traditional AML measures to these emerging products. Indeed, the EU itself notes that the amendments included in 5MLD would not completely rule out any issues regarding anonymity of virtual currency transactions, due to the fact that a great extent of crypto-transactions can also take place outside the purview of such providers.

6.16 Furthermore, there seems to be an element of uncertainty in relation to the scope of the AML rules from FATF and under 5MLD. The definition of virtual assets under FATF, 5MLD and the CJA is technology neutral and therefore indicates that the AML requirements are not restricted to virtual assets based on DLT/Blockchain technology. However, several statements throughout the FATF Guidance indicate that the main characteristic of virtual assets is their feature of entailing a Blockchain/DLT-based layer 1. In addition, FATF is explicit in its "Guidance for a Risk-Based Approach for Virtual Assets and Virtual Asset Service Providers" that the definition of virtual asset is meant to be interpreted broadly based on technology neutrality, which requires jurisdictions to assess the characteristics of the asset, instead of the technology it employs.

6.17 An additional element of uncertainty is created by the lack of harmonisation of AML requirements for VASPs within the EEA. Indeed, the AML rules and VASP registration requirements have varied a great deal between different EU Member States, causing regulatory arbitrage and fragmentation, which in turn requires market participants to be vigilant about this issue when intending on distributing products and services on a cross-border basis. Some of these issues should, however, be dealt with through the new EU AML Package (the final compromise text of which was agreed in February 2024). As part of this package, a new EU Anti-Money Laundering Authority will be established, which will seek to co-ordinate and harmonised the application of AML/CFT requirements across Member States, as well as a new AML/CFT Regulation which will replace the existing Directives.

6.18 Based on the above uncertainties, it will be important for VASPs and other market participants to develop sound internal AML/CFT frameworks. A firm-wide risk assessment strategy enables firms to identify, categorise and target crypto-asset-related risks and create a sound internal framework which meets industry standards.

6.19 Ultimately, we can expect that as VASPs and CASPs become more normalised as financial service providers, they will ultimately be subject to similar AML/CFT requirements. Whilst this will erode some of the perceived benefits and purposes of a decentralised and potentially anonymous system, the potential to expose consumers, businesses, and governments alike to the risk of financial criminal protections being circumvented means that such regulation is inevitable.

6.20 Luckily, third party solutions have been developed to assist crypto market participants in complying with their AML obligations and can provide additional safeguards to supplement their internal

risk infrastructure. Outsourcing operational AML/CFT matters, such as identification and verification of customers, may therefore assist some firms with effectively implementing their AML/CFT obligations. Blockchain monitoring solutions can provide an additional layer of protection (for example with regards to sanctioned wallets). Ireland is currently home to a number of established firms and start-ups specialising in providing these services, having built significant experience in providing similar services to the funds industry and in the context of credit servicing.

7 CROWDFUNDING, LENDING AND CREDIT INTERMEDIATION

7.1 Another area which has been brought into scope of regulation is crowdfunding (i.e. raising funds through a potentially large number of small investments, usually through the internet). The EU Crowdfunding Regulation (Regulation (EU) 2020/1503, the **CFR**) is applicable in Ireland and applies to crowdfunding service providers **(CSPs)** who facilitate: (a) peer-to-peer business lending (consumer lending is not within scope); and (b) investment-based crowdfunding (i.e. where transferable securities are issued/transferred). Initial Coin Offerings **(ICOs)** are generally considered to be out of scope of crowdfunding, although other types of crypto-assets and tokens might be captured, e.g. where they constitute transferable securities or are admitted instruments for the purposes of the CFR. The new regime also does not apply to crowdfunding offers of more than €5,000,000 calculated over a 12-month period. CSPs may, however, in respect of offers which exceed that threshold, fall to be regulated under other regulatory regimes (e.g. under MiFID).

7.2 CSPs that fall within the scope of the CFR must be appropriately authorised to provide crowdfunding services. The authorisation process is similar to other authorisation applications to the Central Bank, including a preliminary meeting, and an application with details of the proposed business, services to be provided, staffing, outsourcing, and governance proposals (including details in relation to those proposed to hold 'controlled function' positions (i.e. senior positions within the entity)) once authorised. There is a statutory time limited of 3 months for consideration of the application. As of 6 September 2024, there are six authorised CSPs on the Central Bank's register. Unlike VASPs, CSPs will benefit from EU passporting rights; allowing the provision of services on a cross-border freedom of services and branch basis in other EEA Member States without the need for local authorisation. Ireland is perceived to be an attractive jurisdiction in which to obtain CSP authosiation and to conduct CSP business in and from (on a potentially passported basis).

7.3 Once authorised, CSPs must comply with the Central Bank's Consumer Protection Code provisions around advertising in Ireland. CSPs will also be subject to operational and prudential requirements as well as investor protection measures.

7.4 Whilst consumer crowdfunding is generally out of scope of this paper, it is worth noting that if an entity is providing credit to consumers as part of crowdfunding, or otherwise, it may be required to become authorised as a retail credit firm. This framework would need to be examined where users are lending or borrowing crypto-assets, for example by way of a DeFi lending protocol, particularly as the scope of credit covered by the retail credit firm (and credit servicing firm) authorisation has been extended to include not just cash lending, but also deferred payments, hire-purchase, consumer leasing, and other forms of financial accommodation provided to natural persons. Further, if an entity is providing credit intermediary services in relation to such loans or credit it may be required to become registered as a credit intermediary pursuant to the Consumer Credit Act 1995.

8 MARKETS IN CRYPTO-ASSETS REGULATION

8.1 As part of the Digital Finance Package from September 2020, the EU published legislative proposals for MiCAR, which is set to create a comprehensive regulatory regime for cryptocurrencies across all EU Member States. MiCAR was formally adopted in May 2023. Chapters III and IV (covering ARTs and EMTs) apply from 30 June 2024, with the remainder of the provisions, together with the Recast FTR, applying from 30 December 2024. On the 14 December 2023, the Department of Finance released its feedback statement on the national discretions contained in MiCAR. The transitional period for CASPs providing services in Ireland prior to 30 December 2024 will be reduced to 12 months. Therefore, the transitional period for CASPs will run until the end of December 2025.

8.2 ESMA has also been tasked with developing regulatory technical standards to support MiCAR's implementation. At the time of writing (September 2024) ESMA has produced three consultation packages containing draft technical standards and guidelines. These three consultation packages include draft regulatory technical standards **(RTS)** and guidelines on a variety of topics, including the conditions and criteria for qualification as financial instruments (discussed above), reverse solicitation under MiCAR, market abuse, expected policies and procedures, suitability requirements, and systems and security access protocols. On the basis of these consultation packages, ESMA has produced three final reports that cover a broad range of topics related to MiCAR, including the information required for authorsation applications for CASPs, acquiring transactions in CASPs, complaints procedures, the exchange of information between competent authorities, and co-operation with third country regulators, sustainability indicators, continuity measures, pre- and post-trade transparency, record keeping, and inside information. Significant. Significant work has therefore been done by ESMA and the Commission to support the full implementation of MiCAR.

8.3 Whilst a full analysis of the requirements under MiCAR are beyond the scope of this paper, at a high level, MiCAR's aim is to implement a regulatory framework for crypto-assets which are not already covered by existing legislation and thereby creates three crypto-asset categories consisting of "asset-referenced tokens" which maintain stability by referring to several currencies or other assets, "e-money tokens" which maintain their value by referring to one fiat currency, and "other crypto-assets" which include standard cryptocurrencies and "utility tokens" which provide access to an application on DLT.

8.4 MiCAR defines crypto-assets as a "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". MiCAR primarily focuses on the issuance of crypto-assets and the provision of crypto-asset services, by requiring providers to meet consumer protection, transparency, conflict of interest and governance standards. More stringent requirements apply to stablecoins which can be considered as either asset-referenced tokens or e-money tokens, in particular those which the EBA classifies as significant.

8.5 MiCAR emphasises that crypto-assets which qualify as financial instruments are already subject to MiFID II. However, it contains some crossover insofar as firms authorised under other EU directives and regulations could issue crypto-assets, falling within the scope of MiCAR, provided that they comply with the additional disclosure obligations under MiCAR.

8.6 Many of the measures set out in MiCAR will be familiar to those working in currently regulated sectors, as it seeks to introduce similar protections for consumers and the market more generally. MiCAR introduces a range of requirements, including for:

- Offerings and marketing to the public of crypto-assets (other than asset-referenced tokens and e-money tokens), including an obligation to publish an information document called a "white paper" (not dissimilar in concept to a prospectus for traditional published offers).

- Asset-reference tokens and e-money tokens (e.g. stablecoins), including an obligation for issuers to be authorised within the EEA and the publication of a white paper in respect of the relevant offering.
- CASPs, including requirements for authorisation, and in respect of specific services such as custody of crypto-assets, trading platforms for crypto-assets, exchange of crypto-assets for fiat currency or for other crypto-assets, and execution of orders.

Additionally, MiCAR introduces a market abuse regime, based on prohibitions of unlawful disclosure of inside information, insider dealing, and market manipulation.

Potential Issues/Deficiencies with MiCAR

8.7 MiCAR has the potential to be a powerful enabler for the development of the crypto-asset industry in the EU, with a simplified regulatory framework enabling compliant businesses to scale and reap the benefits of the Single Market. However, as with many legislative proposals relating to crypto-assets there remain a number of potential issues, ambiguity, challenges and possible deficiencies.

8.8 For example, in terms of categorisation / classification of crypto-assets, the broad definition included in MiCAR will mean that every crypto-asset not falling under a more specific definition (e.g. as e-money or transferable securities) will potentially be captured. It will therefore be necessary to carefully examine the characteristics of each crypto-asset to determine whether it is in scope of MiCAR and identify the appropriate category. MiCAR, however, offers limited clarification to issuers who may be in doubt on how to characterise their offering. Certain types of crypto-assets, for example NFT's (see following section below), may require a detailed analysis of numerous underlying functions to ensure it can be considered 'non-fungible' for the purposes of MiCAR. ESMA's consultation paper on financial instruments provides useful insight in this regard.

8.9 In addition, there are also potential challenges in terms of supervision, including how certain provisions (e.g. market manipulation) can be monitored, identified and enforced by national competent authorities in practice, as well as the potential for regulatory arbitrage.

8.10 MiCAR is also closely linked with civil / criminal liability law at Member State level. As for other EU financial regulation, MiCAR will primarily be enforced by national competent authorities (e.g. the Central Bank), through national procedural rules and the imposition of remedies under national law, including criminal remedies where applicable.

Emerging subsectors and evolving technologies

8.11 Crypto-assets have evolved rapidly in the period since the initial draft MiCAR proposal. Products such as NFTs serve to demonstrate how quickly the market is evolving. Whilst only nominally contemplated in the original MiCAR proposal, NFTs grew to approach mainstream status, before receding in use and value (although obviously not completely defunct). This highlights general concerns with respect to MiCAR's ability to keep pace with innovation.

8.12 With respect to NFT's, MiCAR excludes from its scope those crypto-assets which are unique and non-fungible with other crypto-assets as well as crypto-assets representing services or physical assets that are unique and non-fungible. This therefore excludes tokens accepted only by the Issuer (including most merchant loyalty schemes), representing IP rights, guarantees, certificating authenticity of a unique physical asset, or any other

right not linked to the ones that financial instruments bear and are not accepted to trading at a crypto-asset exchange. In practice, NFTs will need to be examined on a case-by-case basis with respect to their underlying functions in order to determine whether MiCAR will apply to them. ESMA's consultation paper on financial instruments provides useful guidance regarding the criteria to consider when assessing whether a crypto-asset is in fact unique and non-fungible.

8.13 A number of other rapidly growing subsectors are either insufficiently or not catered for at all in MiCAR. For example, DeFi, being decentralised, is often executed through automated mechanisms that make it difficult to identify the constituent actors that MiCAR seeks to apply obligations on. However, MiCAR does not specifically exclude DeFi services or otherwise prohibit them. Instead, difficulties may arise from a lack of clarity on how DeFi services would be able to achieve practical compliance with MiCAR. It should be noted that Article 142 (Report on latest developments in crypto-assets) proposes to assess and evaluate the developments of decentralised-finance in the crypto-assets markets and to assess if certain DeFi-services (such as lending, staking etc.) should be regulated, and if so, how. Similarly, MiCAR does not address a number of other growing segments, such as crypto-lending and borrowing, which will either fall to be dealt with under existing regimes where applicable (e.g. MiFID), or will fall outside of regulation.

9 CONCLUSION

9.1 As has been the case for other financial services over the last 20-30 years, the level of regulatory scrutiny, supervision, and regulation, is likely to increase significantly as the use of crypto-assets and associated services providers, particularly by consumers, becomes increasingly ubiquitous. We have already seen the introduction of requirements for AML/CFT supervision for VASPs, with additional regulation under MiCAR coming into force during the course of 2024.

9.2 Whilst there remain many areas of uncertainty and ambiguity, greater clarity should emerge as the various regulatory regimes bed down and the sector becomes more mature. There will, however, remain tensions between the need for regulation and supervisory oversight, on the one hand, and the development of new technologies and products to support customer needs and demands, on the other.

9.3 Ireland has an experienced regulator, and strong local regulatory controls and oversight, as well as a significant history as an international financial services centre. In addition, Ireland's position as a common law jurisdiction provides it with the flexibility to adapt to new and novel structures where legislation has yet to catch-up (for example, in the area of property rights and smart legal contracts). Its membership of the EU also provides firms with the ability to easily expand services across the EEA. Ireland should therefore remain an attractive jurisdiction in which to establish financial services generally, including crypto-asset vehicles and service providers, in the years ahead.

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