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CRYPTO-ASSET CONSIDERATIONS

Thoughts on incoming regulation
and wider industry adoption

Seen by some as a game-changing innovation and by others as a playing field for financial crime, the crypto asset sector has attracted the attention of regulators worldwide for a number of years. The European Union is now spearheading a new means of supervising this sector through the Markets in Crypto-Assets Regulation (MiCA-R), which came into force in June 2023. With staggered application from 30 June 2024, MiCA-R heralds a new era of regulation for issuers of crypto assets and crypto asset service providers which otherwise fall out of scope of EU financial services legislation.

In this briefing we share our thoughts on which doors MiCA-R may open as well as the challenges it may introduce.

- 1 MiCA-R will impose regulation on a very diverse group of players in the crypto asset sector: from regulated financial services firms—such as credit institutions, MiFID investment firms or electronic money institutions—to specialised crypto firms which may or may not have already been subject to AML rules or apply sophisticated control frameworks. Should more regulated firms decide to offer crypto asset services, this may in practice ‘level up’ the standard for compliance beyond that set by MiCA-R as the competitive advantage could tilt towards those firms in which the market places higher trust. Ultimately, this may affect the ability of specialised crypto firms to compete with market incumbents, which have both greater resources and mature compliance functions at their disposal, and may make partnership with incumbents a more attractive path.
- 2 As in any field of new regulation the actual application of MiCA-R will pose multiple challenges:
 - a. Market participants and regulators will benefit from further harmonised interpretative guidance as concepts familiar within traditional finance, including ‘inside information’ and ‘market manipulation’, are tested within the context of MiCA-R and raise new questions.

- b. While ESMA and the EBA will play a role in ensuring supervisory convergence when applying MiCA-R across the EU, the granting of authorisations under MiCA-R will rest with the national regulators of EEA Member States. While some of those regulators already play a role in supervising certain crypto asset services and their providers under national regimes, such as in Germany and France, others currently lack exposure to this specialised sector. Where jurisdictions are yet to build up institutional knowledge around crypto assets, this will likely lead to uncertainties for applicants in the early days of MiCA-R applying.
 - c. MiCA-R reflects the status of blockchain technology in 2023, and the related Technical Standards will reflect that in 2024. While policymakers were keen to integrate flexibility and regular review clauses into the text, in a sector so open to further technological innovation it is likely that crypto asset service providers and issuers of crypto assets will be faced with ongoing interpretative questions. Policymakers will have to consider whether updates to MiCA-R will be necessary.
- 3 The immutability of the blockchain, and the enhanced ability to trace transactions through the chain (including the history of transactions, the beneficiary and the originator) can make blockchain a powerful tool in the fight against financial crime, in spite of the ‘pseudo-anonymity’ that it offers. However, this analytical functionality also gives rise to questions around whether traditional verification mechanisms (for fiat currencies) are sufficient to comply with AML obligations. In particular, it is unclear what qualifies for crypto assets as ‘constructive knowledge’ to which firms are held accountable when dealing with ‘tainted’ assets.
 - 4 The lack of harmonised regulatory regimes globally is a constant source of uncertainty in a global market and leaves open gaps that can be exploited by criminals using crypto assets.

Navigating the regulatory landscape affecting crypto assets requires a deep understanding of relevant markets, and of the commercial, legal and regulatory considerations underpinning it. The wide-ranging opportunities that crypto asset use present in many sectors means that cross-industry collaboration (including with technology companies) will prove fundamental to achieving better and safer industry adoption of crypto assets.

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