

# Advice to ESMA

## SMSG advice to ESMA on its third consultation paper on the Markets in Crypto Assets Regulation (MiCA)

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## 1 Executive Summary

The SMSG provides opinions and comments on a selection of issues discussed in the third MiCA consultation paper.

Proportionality and riskiness in market abuse monitoring. Proportionality is key to avoiding barriers to small-size players, holding constant all measures targeted to the soundness of the crypto ecosystem. Article 2.3.(a) of the draft RTS on market abuse requires that arrangements, systems and procedures “are appropriate and proportionate in relation to the scale, size and nature of their business activity”. The SMSG considers that the risk of market abuse also depends on other factors (e.g., on the interaction between the scale of the PPAETs activity and the size of the crypto-asset market) and suggests that proportionality should be allowed only when the person professionally arranging or executing transactions (PPAET) shows – e.g., based on empirical evidence or establishing appropriate policies and procedures – that its activity does not imply risks of market abuse at a material level.

The MSG also considers that it would be helpful to clarify whether the monitoring and detection of market abuse for cryptos requires special mechanisms and tools with respect to the mechanisms and tools usually applied to securities markets.

Outsourcing and systemic risk. Article 3.4 of the draft RTS on market abuse sets out the requirements for the outsourcing of the prevention, monitoring and detection activities. To ensure that PPAETs remain in control of those functions, the draft RTS sets out some necessary requirements, such as the existence of a written agreement between the parties and the retention of access to the relevant information and the necessary expertise so the PPAET may assess the work conducted by the delegated party. The MSG believes that the outsourcing of such sensitive tasks should also consider systemic risks (e.g., when several PPAETs delegate the same provider). The relevant authorities may need to monitor the competition and concentration levels of the market related to the outsourced activities.

Coordination procedures between competent authorities. Article 11 of the draft RTS on market abuse requires the competent authority suspecting a case of cross-border market abuse to “report the status of its preliminary assessment to the other competent authorities concerned”. However, there is no expected timing for this reporting activity to occur. To avoid ambiguity and to foster convergence, the MSG believes that it would be useful to specify a precise timing for the exchange of information.

By contrast, the receiving competent authorities shall share information about the existence of any supervisory activity or criminal investigation on the same case “without undue delay”. It appears that an asymmetry in the expected timing exists between the NCA originating the coordination activity and the NCA receiving the preliminary assessment.

The draft RTS also foresees the possibility that competent authorities inform ESMA of the start of an investigation or an enforcement activity. The MSG believes that, instead of being a possibility, ESMA should always be informed in order to have a comprehensive view of the ongoing market abuse investigations in the EU.

Suitability requirements and the understanding of the risks. Article 81(15) of MiCA gives ESMA a mandate to issue guidelines on suitability requirements under MiCA, including the information that crypto-asset service providers (CASPs) shall obtain from their clients or prospective clients. In this respect, Article 81(8) of MiCA requires CASPs to obtain information – among other things – about their basic understanding of the risks involved in purchasing crypto-assets. The MSG believes that, for reasons related to both investor protection and level-playing field, regulation for crypto-assets should be as similar as possible to securities regulation and only differ if this is warranted by differences in product characteristics or risk between MiFID financial instruments and MiCA crypto-assets. With this objective in mind, the requirement of a ‘basic’ understanding of the risks involved in purchasing crypto-assets – although included in the MiCA regulation – appears to be a source of concern in terms of

investor protection. The MSG also notes that the analogous requirement in the MiFID framework refers to understanding (i.e., without ‘basic’).

Sustainability preferences. MiCA suitability guidelines are largely based on the MiFID II guidelines. However, the two sets of guidelines differ in relation to sustainability preferences. ESMA did not include in the draft MiCA guidelines the new additions relating to sustainability preferences that were introduced in the latest version of the MiFID II guidelines (although the draft of the MiCA suitability guidelines suggest that it could be a good practice for CASPs to collect information about the preferences on ESG factors of the client). The MSG highlights that, as the level 1 texts for both MiFID II and MiCA are aligned, level 3 texts should also be aligned.

Transfer services and the relations with clients. The features of the provision of transfer services of crypto-assets share some similarities with payment services, regulated under the Directive on payment services in the internal market (“PSD 2”). Therefore, ESMA has drawn on PSD 2 provisions – where relevant – in developing the draft guidelines. The MSG is in favor of this approach and highlights the need that crypto-asset service providers set up appropriate policies and procedures to assist their customers, as it commonly happens for payment services.

## 2 Background

1. On 25 March 2024, ESMA released the third MiCA consultation paper as part of a series of three packages. Each package includes a number of draft implementing technical standards (RTS) and draft implementing technical standards (ITS). The first consultation paper was published on 20 July 2023 and the MSG provided an Advice to ESMA on 6 October 2023. The second consultation paper was published on 5 October 2023 and the MSG provided an Advice to ESMA on 5 December 2023. This third consultation paper covers the following aspects:
  - i. market abuse in crypto assets<sup>1</sup>;
  - ii. suitability requirements for portfolio management activities under MiCA<sup>2</sup>;
  - iii. transfer services for crypto-assets<sup>3</sup>;

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<sup>1</sup> The consultation paper includes a draft RTS on arrangements, systems and procedures for detecting and reporting suspected market abuse in crypto assets.

<sup>2</sup> The consultation paper includes draft guidelines on certain aspects of the suitability requirements and format of the periodic statement for portfolio management activities under MiCA.

<sup>3</sup> The consultation paper includes draft guidelines on procedures and policies, including the rights of clients, in the context of transfer services for crypto-assets.

- iv. systems and security access protocols<sup>4</sup>.
- 2. In this Advice, the SMSG provides its views on specific questions raised by ESMA in the consultation paper as well as comments on more general issues that are related to the topics discussed in this consultation.

### **3 SMSG opinions and comments on market abuse**

#### **3.1 General approach, proportionality and riskiness in market abuse monitoring**

- 3. ESMA considers that the draft technical standard should require that persons professionally arranging or executing transactions (PPAETs) to establish arrangements, systems and procedures that ensure an effective and on-going monitoring of transactions, orders and other aspects of the functioning of the distributed ledger technology and allow for the reporting of suspicious transactions or orders to the relevant NCA.
- 4. The SMSG supports the approach put forward by ESMA to monitor market abuse, as it is a key aspect for the long term success of the crypto ecosystem.
- 5. ESMA also notes that – considering that the size, nature and scale of the business activity carried out by PPAETs may vary significantly – it is important to ensure that systems, arrangements and procedures developed by PPAETs are proportionate and appropriate to comply with the STOR (i.e., suspicious transaction or order report) regime. At the same time, ESMA also considers as important that these systems and procedures are adequately calibrated to the risk dimension of the activities carried out by PPAETs.
- 6. Specifically, article 2.3.(a) of the draft RTS on market abuse requires that arrangements, systems and procedures “are appropriate and proportionate in relation to the scale, size and nature of their business activity”.
- 7. The SMSG believes that this provision may imply overlooking the risk dimension of the activities carried out by PPAETs. The risk of market abuse does not depend only on the scale, size and nature of the business activity of the PPAETs. It also depends, e.g., on the interaction between the scale of the PPAETs activity and the size of the crypto-asset market. For this reason, we are of the opinion that article 2.3.(a)<sup>5</sup> should be amended to include that the proportionality should be allowed only when the PPAET shows – e.g.,

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<sup>4</sup> The consultation paper includes draft guidelines on maintenance of systems and security access protocols in conformity with appropriate Union standards.

<sup>5</sup> See Q2 (“Do you agree with the proposed elements that should constitute appropriate arrangements, systems and procedures to detect and prevent market abuse? If not, please specify the article of the draft RTS and elaborate”).

based on empirical evidence or establishing appropriate policies and procedures – that its activity does not imply risks of market abuse at a material level.

8. The MSG also considers that it would be helpful to clarify whether the monitoring and detection of market abuse for cryptos requires special mechanisms and tools with respect to the mechanisms and tools usually applied to securities markets.

### **3.2 Outsourcing and systemic risk**

9. ESMA considers that PPAETs may delegate their prevention and detection activity, including the performance of data analysis and generation of alerts, to a third party or to a person of the same group.
10. To ensure that PPAETs remain in control of those functions, the draft RTS sets out some necessary requirements, such as the existence of a written agreement between the parties and the retention of access to the relevant information and the necessary expertise so the PPAET may assess the work conducted by the delegated party.
11. Specifically, article 3.4 of the draft RTS on market abuse sets out the requirements for the outsourcing of the prevention, monitoring and detection activities.
12. The MSG believes that the outsourcing of such sensitive tasks should also consider systemic risks (e.g., when several PPAETs delegate the same provider). The relevant authorities may need to monitor the competition and concentration levels of the market related to the outsourced activities.

### **3.3 Coordination procedures between competent authorities**

13. With respect to the coordination procedures between competent authorities for detection and sanctioning of cross-border market abuse situation, ESMA considers that the draft technical standard should provide for an efficient coordination procedure for the detection of cross-border market abuse, in particular by requiring a timely exchange of information that ensures that all the NCAs potentially involved have all the elements to decide whether to pursue a potential investigation or not.
14. To avoid ambiguity and to foster convergence, the MSG believes that it would be useful to specify a precise timing for the exchange of information: article 11 of the draft RTS on market abuse requires the competent authority suspecting a case of cross-border market abuse to “report the status of its preliminary assessment to the other competent authorities concerned”. However, there is no expected timing for this reporting activity to occur.

15. By contrast, the receiving competent authorities shall share information about the existence of any supervisory activity or criminal investigation on the same case “without undue delay”. It appears that an asymmetry in the expected timing exists between the NCA originating the coordination activity and the NCA receiving the preliminary assessment<sup>6</sup>.
16. The draft RTS also foresees the possibility that competent authorities inform ESMA of the start of an investigation or an enforcement activity. The MSG believes that, instead of being a possibility, ESMA should always be informed in order to have a comprehensive view of the ongoing market abuse investigations in the EU. Indeed, MiCA level 1 text provides good arguments to consider this as a requirement rather than as a possibility. We list such arguments in the next paragraph.
17. First, the first paragraph of Article 95(1) provides that competent authorities should cooperate with each other and render assistance to NCAs of other Member States and to EBA and ESMA. They should exchange information without undue delay and cooperate in investigation, supervision and enforcement activities. Second, the second paragraph of Article 95(1) provides that, where Member States have laid down criminal penalties for certain market abuse infringements of MiCA, they shall ensure that appropriate measures are in place so that NCAs have all the necessary powers to liaise with judicial, prosecuting or criminal justice authorities within their jurisdiction to receive specific information related to criminal investigations or proceedings commenced for infringements of MiCA and to provide the same information to other competent authorities as well as to EBA and ESMA, in order to fulfil their obligation to cooperate for the purposes of MiCA. Third, there are only limited reasons to refuse an exchange of information (see Article 95(2) of MiCA). Fourth, EBA and ESMA shall fulfil a coordination role between competent authorities and across supervisory colleges as referred to in Article 119 with a view to building a common supervisory culture and consistent supervisory practices and ensuring uniform procedures. (Article 95(8), second paragraph), providing a further argument for ESMA and EBA to be fully informed.

## **4 MSG opinions and comments on suitability**

### **4.1 General approach and the understanding of the risks**

18. The assessment of suitability is an important investor protection requirement under MiCA. It applies to the provision of advice on crypto-assets and portfolio management of crypto-assets.

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<sup>6</sup> See Q7 (“Please provide information about the estimated costs and benefits of the proposed technical standard, in particular in relation to the arrangements, systems and procedures to prevent and detect market abuse”).

19. Article 81(15) of MiCA gives ESMA a mandate to issue guidelines on the following aspects of the suitability requirements under MiCA: (i) the criteria for the assessment of client's knowledge and competence; and (ii) the information that crypto-asset service providers shall obtain from their clients or prospective clients regarding their knowledge of, and experience in, investing (including in crypto-assets), their investment objectives (including risk tolerance), their financial situation (including their ability to bear losses), and their basic understanding of the risks involved in purchasing crypto-assets, so as to enable crypto-asset service providers to recommend to clients or prospective clients whether or not the crypto-assets are suitable for them and, in particular, are in accordance with their risk tolerance and ability to bear losses.
20. The SMSG believes that, for reasons related to both investor protection and level-playing field, regulation for crypto-assets should be as similar as possible to securities regulation and only differ if this is warranted by differences in product characteristics or risk between MiFID financial instruments and MiCA crypto-assets. With this objective in mind, the requirement of a 'basic' understanding of the risks involved in purchasing crypto-assets – although included in the MiCA regulation – appears to be a source of concern in terms of investor protection. The SMSG also notes that the analogous requirement in the MiFID framework refers to understanding (i.e., without 'basic')<sup>7</sup>.

## 4.2 Sustainability preferences

21. ESMA chose to largely base the MiCA suitability guidelines on the MiFID II guidelines. This is because the MiCA suitability requirements are also largely based on the MiFID II suitability requirements.
22. However, the two sets of guidelines differ in relation to sustainability preferences. The MiFID II guidelines were reviewed recently to integrate new obligations relating to sustainability preferences into the suitability requirements under MiFID II (Delegated Regulation (EU) 2021/1253). In contrast with MiFID II and the MiFID II Delegated Regulation, MiCA does not include an express obligation to collect information on clients' or potential clients' sustainability preferences.
23. ESMA thus did not include in the draft guidelines presented in the third MiCA consultation paper the new additions relating to sustainability preferences that were introduced in the latest version of the MiFID II guidelines. However, paragraph 27 of Guideline 2 (*Arrangements necessary to understand clients*) of the draft guidelines suggests that, at this stage, it could be a good practice for crypto-asset service providers to collect

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<sup>7</sup> ESMA guidelines on certain aspects of the MiFID II suitability requirements state in paragraph 23 that "firms should also take reasonable steps to assess the client's understanding of investment risk as well as the relationship between risk and return on investments".

information about the preferences on environmental, social and governance factors of the client or potential client.

24. The MSG highlights that, as the level 1 texts for both MiFID II and MiCA are aligned, level 3 texts should also be aligned for the following reasons. Both the MiFID II and MiCA level 1 texts refer to the need to assess clients' *"investment objectives, including risk tolerance"*, without referring to sustainability preferences. In respect of MiFID II, the level 2 Delegated Regulation (EU) 2017/565 has introduced a definition of sustainability preferences (art. 2(7)) and develops the requirement to ask information on investment objectives by stating that investment firms should obtain information on clients' *"investment objectives including the client's risk tolerance and any sustainability preferences"* (art. 54(2) a)). In respect of MiCA the Level 1 text did not give a mandate to the Commission to issue a level 2 text in respect of the suitability requirements. The MSG is of the view that this not a sufficient reason to have different level 3 guidelines since (i) the level 1 texts of MiFID II and MiCA in respect of the suitability test use exactly the same wording (*"investment objectives, including risk tolerance"*); and (ii) level 2 texts can only supplement or amend non-essential elements of the Level 1 Act (art. 290 TFEU). It is clear that MiFID II Delegated Regulation (EU) 2017/565 has not issued a new legal rule, but merely clarified how broadly the term *"investment objectives"* should be interpreted (i.e., also including sustainability preferences). The fact that MiCA does not provide for a Level 2 Delegated Act, does therefore not prevent ESMA to fully align the MiCA guidelines with the MiFID II guidelines in respect of sustainability preferences. From a legal coherence perspective, it would also make more sense to fully align the MiFID II and MiCA suitability guidelines on this point. Nor from a legal perspective, nor on the basis of differences in product characteristics or risks between financial instruments and crypto-assets, the MSG believes there are any reasons to apply different requirements in relation to sustainability preferences.

## 5 MSG opinions and comments on transfer services for crypto-assets

### 5.1 General approach and the relations with clients

25. The features of the provision of transfer services of crypto-assets share some similarities with payment services, regulated under the Directive on payment services in the internal market ("PSD 2"). Therefore, ESMA has drawn on PSD 2 provisions – where relevant – in developing the draft guidelines.
26. The MSG is in favor of this approach and highlights the need that crypto-asset service providers set up appropriate policies and procedures to assist their customers, especially when the access to the wallets (or similar services) is only based on keys and pass codes, as it commonly happens for payment services.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 21 June 2024

[signed]

Veerle Colaert  
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[signed]

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