



Policy 4.0

POLICY FOURPOINTO RESEARCH FOUNDATION

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Public Comment on ESMA's Technical Standards specifying certain requirements of the Markets in Crypto Assets Regulation (MiCA), 12 July 2023

Dear Member of the ESMA Board,

Policy 4.0 welcomes the opportunity to comment on ESMA's consultation report which outlines the first set of technical standards around the MiCA bill. If implemented, the recommendations could offer a viable pathway to effectively leverage the new opportunities and manage the inherent risks and challenges in the niche financial system.

Policy 4.0 is a new-age think tank on emerging technology established in 2020 in New Delhi, India. By combining deep expertise in engineering, economics, finance and geopolitics, we develop unique and unbiased insights to support cutting-edge policy approaches. We focus on exploring the intricacies and addressing the systemic disruptions created by emerging technologies. Since inception, we have developed multiple impactful global studies, including recommendations incorporated in the G20 cryptoasset guidance in 2023, a 4-part report series on a reverse engineering of China's digital yuan and its comparison with dollar infrastructure, and a technical approach to crypto regulation

In the last year, our engagements have focused on the examination of critical regulatory risks inherent in crypto and digital asset ecosystems since the Crypto Winter —as part of our crypto contagion series. The first report in this series, on interdependencies, was well-received by regulators in over 40 countries and presented to SSBs. Within this ongoing work in the series, we explore the technical underlying dynamics of crypto entities with the aim of evaluating viable and practical supervision tools and strategies for ensuring efficiency in crypto ecosystem. The recommendations of this report have been incorporated into the final global cryptoasset rules endorsed by the G20, as recommendation 8 of the FSB. We are honored to see a similar discussion in the ESMA technical standards. To a large extent, the findings from these engagements and insights from high-level interactive forums with global stakeholders inform our views in this letter.

Feedback on interdependency provisions

Interconnections are at the heart of the crypto-asset market's functionality and stability. The stipulations outlined in Article 34 of the MiCA Regulation appropriately underscore the necessity for crypto-asset service providers to identify, assess, and mitigate the risks associated with their interconnections. The measures, as proposed, aim to enhance the resilience and monitoring capabilities of these service providers. The European Parliament's additions, namely the reporting requirements, and the mandate for ESMA to develop interconnection guidelines, significantly bolster the regulatory framework.



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The Council of the European Union's elucidations on the definition of interconnections are invaluable in ensuring comprehensive coverage. By encompassing technical, commercial, and financial interconnections across various entities, the MiCA Regulation inherently recognizes the multifaceted nature of these relationships within the crypto-asset market. This inclusivity is paramount in effectively addressing the risks posed by interconnectedness.

However, as the crypto contagion incident highlighted, there remain areas of improvement to fortify the regulatory framework surrounding interconnections. We propose the following measures for ESMA's consideration:

1. **Enhanced Disclosure Requirements:** CASPs should be mandated to disclose comprehensive information about their interconnections. This would furnish ESMA with a more nuanced understanding of the interconnectedness landscape, facilitating the identification of potential risks.
2. **Risk Concentration Limits:** Implementing caps on the concentration of risk is imperative to curb the potential for contagion and systemic instability. Such limits would serve as a prudent safeguard against unforeseen adverse events.
3. **Stress Testing:** CASPs should be required to conduct stress tests on their interconnections. These assessments will pinpoint vulnerabilities that may render them susceptible to contagion or systemic instability, enabling proactive rectification.
4. **Counterparty Failure Contingency Plans:** CASPs should establish contingency plans to effectively navigate the aftermath of a counterparty failure. These plans would serve as a critical buffer, mitigating the broader impact on the crypto-asset market.
5. **Guidelines for Interconnection Management:** ESMA should develop comprehensive guidelines to empower CASPs in identifying, assessing, mitigating, and reporting on their interconnections. This practical advice will significantly augment their risk management capabilities.

Additionally, ESMA's collaboration with other regulatory bodies, particularly central banks of EU member states, is essential for establishing a cohesive and consistent approach to interconnection regulation within the crypto-asset market. This alignment is vital in ensuring the efficacy of the regulatory framework across the EU.

Alignment with the G20 rules

Transitioning into harmonization and cross-border coordination, especially in conjunction with the G20 guidance, is a pivotal step. While the MiCA text and ESMA standards align well with several aspects of the G20 framework, there are notable disparities, particularly regarding the segregation of functions.

Although not explicitly mandated, the implementation of a segregation of functions is a fundamental risk management measure. While MiCA does require robust internal controls, the



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absence of a specific segregation mandate could potentially hinder coordination efforts with other jurisdictions and lead to increased operational risks.

In light of this, it is recommended that ESMA consider advocating for a segregation of functions as a best practice, even if it is not expressly mandated by law. This measure would fortify risk management within CASPs, safeguarding both providers and their clientele.

Looking ahead to supervision

We look forward to the ESMA's supervisory guidance for the cryptoasset ecosystem. A significant number of challenges in the space can be mitigated with a robust supervisory framework and supervision capabilities. We have developed an 88-parameter framework for supervision of CASPs and are building deep research and dashboards for the same. We would be happy to support the ESMA with inputs on the same in future roundtables and discussions they convene on the matter.

Respectfully Submitted,

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Founder & CEO
Policy 4.0.