Response to European Supervisory and Markets Authority (ESMA) consultation (second batch) under the Markets in Crypto Assets (MiCA) Regulation

December 2023

Introductory comments

The Crypto Council for Innovation (CCI) - the premier global alliance advancing crypto innovation - welcomes the opportunity to provide input into the second batch of draft RTS/ITS and Guidelines under the EU’s MiCA legislation put out for comment by ESMA.

CCI and our members believe in:

- Inclusive regulation;
- Leading with a global worldview;
- Developing actionable and evidence-based insights
- Working in trusted partnership with government and business stakeholders.
- Unlocking the promise of web3.

We appreciate ESMA's willingness to have a constructive dialogue with industry through this consultation process. We are also grateful to ESMA for taking the time to meet with a delegation of our Europe working group in October - this response builds on our input given during and after that meeting.

General comments

CCI welcomes ESMA's constructive and comprehensive approach to the consultation paper (CP). We believe it is important that ESMA remains open to modify and further adapt its draft proposals based on expert input it receives from industry representatives and other specialists in the field in response to this CP.

We have chosen to respond selectively to this CP where we believe we can add value. As such, our response is a combination of general comments as well as specific responses to a subset of more specific questions. We believe our individual members, as well as other ecosystem operators, are better placed to answer more business-centric, technical questions.

Finally, we fully support the EU’s MiCA legislative framework insofar as it provides helpful clarity on the operating environment and legislative/regulatory framework applicable to stablecoin issuers and CASPs. However, we would underscore the fundamental importance of the ‘level 2’ work currently being undertaken by...
the European Supervisory Authorities (ESAs). If these technical standards are appropriately crafted, they can provide important additional clarity and certainty to current and future market operators active in the EU. This will help drive investment and innovation in the EU, something we believe was the intention of the co-legislators in developing the MiCA framework in the first place (alongside putting in place important financial stability and consumer protection provisions). Conversely, if the draft regulatory technical standards are overly prescriptive or do not take into account the specificities of the ecosystem, they will have a chilling effect on innovation and competition, which would hamper the overarching ambition of the MiCA regime.

High-level overview

This section of our response provides some high-level, discursive views of the draft proposal, broken down by theme as per the structure/layout ESMA proposed in the CP. We focus on three chapters in particular:

Sustainability indicators

ESMA's draft Regulatory Technical Standards (RTS) in relation to sustainability need to balance the political mandate from MiCA of requiring the collection and mandatory disclosure of sustainability data, against the practical challenges of data availability and reliability in the cryptoasset market.

We broadly support the approach of aligning definitions and concepts with existing EU sustainability reporting requirements (CSRD and CSDD). As a rule of thumb, and in order to ensure greater consistency between operators, it is preferable to use definitions and concepts which already exist rather than developing new ones. This also helps to ensure a level playing field between different types of operators covered by different pieces of EU legislation. That said, we believe the differing scope of CSDR and SFDR regimes - which apply to a well-defined set of large corporates (CSDR) and financial institutions (SDFR) - compared to these draft RTS - which also apply to start-ups and SMEs - will impose burdensome requirements, constituting a lack of parity across the files.

We are also concerned that the extension of traditional sustainability reporting requirements to decentralized protocols would be untenable and undesirable. We appreciate ESMA's recognition that there are challenges associated with gathering sustainability data given the global, distributed nature of decentralized protocols. Recognizing that regulations for decentralized protocols will be covered in future rulemaking processes, we appreciate this opportunity to share our concern that requiring decentralized protocols to fulfill sustainability reporting requirements through traditional, intermediated means could undermine the fundamental nature of these systems. Given their distributed, open-source nature, decentralized protocols do not have traditional centralized intermediaries capable of providing this data on their behalf. While we appreciate the importance of gathering this data, we would welcome the opportunity during future rulemaking to share mechanisms by which this data could be supplied in a manner consistent with the unique nature of decentralized protocols.

Relatedly, we fully support ESMA's approach towards allowing the use of best effort, estimates and third parties when it comes to collecting and sharing data points regarding sustainability indicators with public authorities. This is particularly important given the international nature of the industry, which often involves counterparties outside the EU where there may not be jurisdictional requirements which require the same recording of sustainability data. The chosen approach will, in our view, facilitate compliance whilst data gaps exist and/or
data reliability varies. Having said this, we do fear that data reliability and inconsistent calculation methods mean the measures, as drafted, may create barriers to entry which cannot be overcome by new entrants and emerging businesses, and therefore cause the EU cryptoasset market to be practically unavailable for start-ups and SMEs.

We note that ESMA seeks information about energy intensity on a transaction by transaction basis. However, numerous transactions are often bundled into larger collections for processing on a DLT network (e.g. in the case of bitcoin transactions are bundled into blocks). We further note that ESMA also references “total amount of energy used per calendar year, for the validation of transactions”. In our view this is a more appropriate basis on which to consider energy intensity. Alternatively, ESMA might consider the ‘Average amount of energy used, in kWh, per transaction block’.

Business continuity requirements

CCI understands that the approach ESMA has taken is largely inspired by existing primary and secondary legislation, notably DORA and MiFID/R. CCI supports ESMA’s approach to replicate/align with these existing provisions in order to avoid duplication and ensure consistency amongst different market operating entities/firms.

We support the assertion that business continuity requirements should contribute to the maintenance of orderly markets by limiting, to the extent possible, undue losses for clients of CASPs in the event of a disruptive incident.

We are encouraged to see a detailed section in the CP and in the draft RTS on permissionless DLT. We fully agree with ESMA’s assessment/interpretation regarding no liability for CASPs using permissionless DLT, as these would not fall under the scope of MiCA’s outsourcing article.

However, we recognise ESMA distinction regarding permissioned DLT operated by a commercial enterprise as a “third-party provider”. We also acknowledge the stance that CASPs remain liable for any losses related to their own smart contracts, such as hacks or exploits, regardless of whether they are deployed on a permissionless or a permissioned DLT.

We agree with ESMA’s proposal that CASPs should not be required to establish a dedicated business continuity function but that CASPs are required to have dedicated resources for their business continuity arrangements, with the management body reviewing business continuity policy on at least an annual basis. We believe current best practice in the market is already in keeping with such requirements.

Trade transparency data and order book record-keeping

The RTS specify the level of disaggregation of data to be made available to the public for centralized exchanges, whilst enumerating the types of pre and post trade transparency required. These detailed requirements, whilst onerous/burdensome from an operational compliance perspective, seem to have been largely inspired by/drawn from approaches taken in existing EU legislation, in particular MiFID/R. To the extent that the read across is relevant for crypto-markets, CCI acknowledges that this approach does have the merit of ensuring consistency and coherence between different operators within the EU’s single market.
We welcome the thoughtful stance towards decentralized exchanges (DEXs) and the recognition that the rulebook may need to adapt/be differently calibrated to reflect the nature of DEXs compared to centralized exchanges (CEXs). Indeed, while we recognize that regulations for decentralized protocols will be covered in future rulemaking, we strongly believe that ESMA and other relevant stakeholders will need to develop distinct rules for decentralized protocols that acknowledge their different risk profiles and the public benefit they provide. Decentralized protocols reduce counterparty risk while increasing financial access, transparency, security, and participatory stakeholder governance. We believe that regulation should help realize these benefits by incentivizing decentralization.

However, we share ESMA’s concern that creating different rules for decentralized protocols could have the effect of engendering “decentralization arbitrage” - where businesses claim to be decentralized although they are not. To mitigate this risk and assist ESMA in determining whether a protocol is in fact decentralized, we suggest that protocols be subjected to principles-based assessments making use of objective statutory criteria. We have elsewhere proposed tests to assess decentralization and look forward to supporting future rulemaking on this to ensure that regulation is risk-calibrated while realizing the public benefits of these technologies.¹

Critically, regulators should note that developers and businesses building protocols may initially create a centralized system that then becomes a decentralized protocol. We believe that this process should be incentivized for the public benefits it creates and, as such, that a protocol may be evaluated for decentralization multiple times.

Given the resource-intensive and potentially inconsistent nature of determining whether a protocol is decentralized on a case by case basis, we suggest that regulators instead adopt a principles-based approach when assessing the decentralization of a blockchain or smart contract protocol. It is critical that decentralization be capable of being assessed objectively with clear statutory criteria, rather than being dependent on regulatory discretion in each case. In that spirit, we propose that in future rulemaking ESMA and relevant supervisory and regulatory bodies develop a principles-based approach that would enable decentralized protocols to be clearly identified in lieu of an onerous ad hoc analysis that may produce inconsistent interpretations and an unlevel playing field, discouraging competition and new market entrants. The aforementioned tests could form a core component of such an approach.

Furthermore, rather than applying regulation to open-source software, decentralized protocols that cannot practically comply with subjective and differing global regulations, regulation should seek to mitigate risks by targeting centralized applications, or businesses, that provide an interface for interacting with protocols. It is important to determine what regulations should apply to frontend applications, or businesses, facilitating use of a DEX. We believe that how regulation is targeted at the application or business level should depend on the type of regulation, and on criteria about the application, such as whether it is a CEX, an established for-profit app, nascent for-profit app, purpose built not-for-profit, not purpose built, not-for-profit, or decentralized autonomous organization (DAO).

¹ For example, protocols can be assessed based on whether any single person or group of persons can control or fundamentally alter a protocol’s purpose or code, control user funds or assets, reverse transactions, or restrict access to the protocol. If the answer is no, then the protocol is decentralized. Otherwise, the protocol would not be considered decentralized. Furthermore, protocols should be assessed on whether they are built on top of a public and permissionless blockchain. If they are not, then the private and permissioned features of the base blockchain could curtail the decentralization of the protocol in question.
We look forward to providing further clarification on how this principles-based, risk-calibrated approach to regulation could work in practice and, given that rulemaking for decentralized systems will be covered in the future, we are grateful for the opportunity to proactively provide this high-level summary of considerations here.

We have further covered these points in our [white paper on Key Elements of an Effective DeFi Framework](#) and welcome opportunities to clarify how decentralized elements of the crypto ecosystem ought to be addressed to achieve crucial policy objectives without stymieing the transformative potential of this innovation, which extends far beyond finance. Indeed, DeFi is just one subset of a broader category of evolving decentralized services including social media, commerce, and identity. Ensuring that rules are well-adapted to the unique benefits, and risks, of decentralized technologies is crucial to realizing the broad benefits of these technologies.

**Detailed responses to individual CP questions**

In this section of our response we provide some more granular, detailed responses to select individual questions from the CP.

**Sustainability**

**Q1: Do you agree with ESMA's assessment of the mandate for sustainability disclosures under MiCA?**

CCI welcomes the approach ESMA is taking on sustainability. In particular we think the approach of identifying three core sustainability indicators (node energy consumption, node location, devices used by a node) is sensible.

We fully support ESMA's approach of not seeking to contrast different consensus mechanisms.

Our broader position is that it is important that any mandatory disclosure focuses not just on the consumption of electricity, but ties this closely to emissions, as we believe it was the policymakers' political intention in the MiCA legislation to focus on the latter.

We welcome ESMA's focus on GHG emissions. The mandatory disclosures emphasize energy consumption and intensity, yet these metrics do not necessarily reflect the overall sustainability, greenhouse gas (“GHG”) emissions, or carbon footprint of a protocol. Further, we would look to ensure each disclosure is considered as the whole picture: An increasing majority of contributors DLT ecosystems are based on renewable electricity, often creating positive externalities by incentivising new electricity generation in the first instance.

The current proposed mandatory disclosure focuses on non-renewable consumption. We agree that the consumption of non-renewable energy is environmentally detrimental, so support this. However, it may also be desirable for regulators to consider renewable energy consumption as an indicator of good industry practice. We believe the RTS would benefit from being amended to ensure there is space to properly consider the renewable benefits, while not increasing the data return burden on industry and whilst taking into account of the nature of the operators' ability to report (i.e. such requirements would not be possible for decentralized exchanges and/or decentralized protocols).
Regarding the location of nodes: Information regarding the geographical location of nodes and the specific devices they employ is often neither accessible nor dependable. Consequently, such data cannot reliably serve as a proxy for estimating GHG emissions, waste production, or the impact on natural resources. We do not believe this should be considered a particular factor - given the requirement to disclose electricity sources means that the specifics of a node can be captured, rather than the risk arising from their location, for example in a country with a high fossil fuel energy mix.

Q3: Do you agree with ESMA’s approach to ensure coherence, complementarity, consistency and proportionality?

From a structural perspective, we agree on the proposed approach to bundle mandates into a single RTS for clarity. This should also facilitate the subsequent delegated acts and scrutiny process for the EU institutions.

The complexity of the sustainability disclosures may exceed the grasp of retail customers, thereby compromising the objective of making such information understandable - a criticism that is often directed at other energy-related metrics, such as those underlying energy utility bills.

We would welcome a stronger emphasis on proportionality, particularly for start-ups and SMEs. ESMA could consider taking into account an in-scope person’s size, revenue, sophistication, and therefore financial and non-financial resources, for example, adding in quantitative thresholds to be met before the disclosure requirements are triggered (based on cryptoasset volume / value / market capitalisation, within a period e.g. annually or within a three-year period).

Q4: Do you agree with ESMA’s approach to mitigating challenges related to data availability and reliability? Do you support the use of estimates in case of limited data availability, for example when data is not available for the entirety of a calendar year?

We support ESMA’s approach to allowing estimates where data is hard to gather. For example, garnering a full picture of how very decentralized nodes (such as hobbyists) power their work will be difficult to understand, whilst the work of larger miners is likely to be clearer.

However, we do have concerns regarding the proposed requirements for sustainability disclosures being complex and burdensome. Many issuers will likely need to engage specialist consultants or make costly expert hires, both in terms of finances and time. This is hugely problematic for SMEs - and may be a strong disincentive from launching in the EU.

Currently, there is also a lack of uniform methodologies for calculating the energy consumption of consensus mechanisms and individual network nodes, which further complicates compliance.
Continuity and regularity in the performance of crypto services

Q13: Is the definition for permissionless DLT in Article 1 sufficiently precise?

We believe the definition ESMA has produced in article 1 is precise. However, we would query whether it precludes models where there is a single steward managing and maintaining a process. If so, we believe the definition should be amended to clarify this via the deletion of "or provides core services for the use of such distributed ledger". Without this definitional clarification, the definition as currently drafted could cut across open source software projects where an organization acts as steward and would not be aligned with the approach we understand is being taken in other relevant legislation (e.g. the Cyber Resilience Act).

We particularly welcome and support ESMA’s description of permissionless DLTs as a form of “common good” resource. This conceptual approach aligns to our own description and vision for permissionless DLT blockchains as ‘Public Good Protocols’ - see p15 of our white paper on Key Elements of an Effective DeFi Framework for more details on this.

Q14: Throughout the RTS, we refer to ‘critical or important functions.’ The term is borrowed from DORA and does not just capture ICT-specific systems. Does this approach make sense?

We believe the approach does make sense given that CASPs are already caught by the DORA requirements and therefore applying the same definitions/terminology ensures consistency and improves clarity.

Q16: Should this RTS also specify that CASPs should establish a business continuity management function (to oversee the obligations in the RTS)? In your view, does this fall within the mandate of ‘measures’ ensuring continuity and regularity?

We believe that ESMA has taken the right approach by ensuring robust and detailed provisions regarding business continuity but not going as far as mandating a dedicated management function. This principles-based approach recognises the differences in size, scale and risk of this nascent ecosystem compared to larger, more systemic parts of the financial system, where a dedicated management function is merited.

Q18: Do you consider the obligation for CASPs to conduct testing of the business continuity plans in Article 4(4) via an internal audit function appropriate for the mandate?

We believe the RTS as drafted provide a sufficiently calibrated framework allowing for a robust and clear process to ensure business continuity requirements are effectively implemented.
We would like to bring to ESMA's attention, however, the fact that many institutions do not have a dedicated business continuity function, and therefore some of the provisions outlined here could constitute a disproportionate requirement, particularly for start-ups and SMEs.

Q19: In Art. 68(8), CASPs are required to take into account the scale, nature, and range of crypto asset services in their internal risk assessments. Is there support for this general principle on proportionality in Article 6? Do you support the proposed selfassessment under Article 6(2) and in the Annex of the draft RTS?

We strongly support ESMA's general principle on proportionality in Article 6 when it comes to internal risk assessments for CASPs. We believe a risk-based approach is the right one here and in keeping with the legislators' stated intention in the MiCA legislative text.

We support the proposed self assessment under Article 6(2) and in the Annex of the draft RTS - CASPs are best placed in the first instance to understand their business models and provide the necessary data points as outlined in the annex, which seem to be a comprehensive but reasonable amount of reporting from a compliance burden perspective.

**Offering pre- and post- trade data to the public**

Q20: Do you agree with the description provided for the different types of CEX and DEX listed?

We believe the general descriptions as outlined by ESMA in paras 90-99 of the CP document broadly cover the main features of CEXs and DEXs including the differences between the two.

Q22: Do you consider the trading systems described, and the transparency obligations attached to each trading system, in Table 1 of Annex I of the draft RTS appropriate for the trading of crypto-assets?

The type of trading systems described seem sufficiently detailed to ensure comprehensive capture of significant pre-trade transparency information to be made public.

Q27: Do you agree with the proposed list of post-trade information that trading platforms in crypto assets should make public in accordance with Tables 1, 2 and 3 of Annex II of the draft RTS? Please provide reasons for your answers.

We agree with the proposed list as we believe it provides a comprehensive amount of past trade data which is useful for investors and promotes transparent and efficient markets.

One suggestion we would like to make: ESMA may wish to consider pushing the timing requirements to [one] minute, so as to be consistent with the requirements under MiFID for the post-trade transparency of equity products.