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February 16, 2024

Look Ahead Calendar – PolicyPartner

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- Talks of MiCA 2.0
 - Takeaways from Talos/PolicyPartner call with Portugal/ MiCAR experts
 - FinCEN moves to cover RIAs and ERAs
 - Republicans lose a House seat, undermining an already slim majority
 - House Financial Services Committee right sizes AML narrative
 - Takeaways from PolicyPartner call with HFSC
 - Letitia James presses DCG
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Talks of MiCA 2.0

With MiCA coming into force this year, there already seems to be interest in a new legislative effort to mend gaps in the coming regulation. While MiCA establishes floor for a regulatory framework in Europe, there are legitimate questions surrounding the obligations for MiFID businesses, and the interplay between the two regimes, the role of market makers, and the rules around DeFi. As the National Competent Authorities assess their readiness to implement MiCA, we might see some initial steps for supplemental legislation to take place.

Takeaways from Talos/PolicyPartner call with Portugal/ MiCAR experts: **Replay of the call available [here](#)**

Trade reporting and algo oversight:

Mica will introduce new reporting requirements for crypto asset service providers around trade data that will likely mirror MiFID reporting and the market abuse regulation. While some provisions in MiCA are similar – they are generally not as extensive as the regulation. Particularly, MiCA does have requirements to provide information on market practices - crypto trading platforms must have systems that are “resistant to errors and are creating safe trading environment”. The third consultation is going to discuss market abuse and the final version may have algo provisions, as it includes questions from ESMA on trade transparency and data that needs to be provided to the regulators. DORA is also one of the key regulations for trading technology providers and financial firms in general.

When to expect compliance/enforcement actions:

MiCA is a soft regulation with a grandfathering regime as well as the grace period for CASPs. 2026 – 2027 is likely to be period of strong enforcement, given extended periods of implementation.

Stablecoins:

Only 2 E-money institutions registered with the Bank of Portugal. Having other issuers with pending registrations operate in the EU would likely create a disadvantageous situation for the registered entities. Based on PSD2 – requirements for EM institutions are quite stringent. The time to get an approval for e-money institutions is ~1.5 years and given that the regulators are most concerned with systemic risks of stablecoins grace period likely to not be possible. Finally,

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while exchanges could assume liability for listing tokens that are issued not according to MiCA rules, they would be unable to do so for stablecoins – leading to EU-based exchanges likely listing only MiCA-licensed stablecoins.

Differences between jurisdictions:

- Non-regulatory factors: tax policy, labor laws, investment rules.
- Knowledge and sophistication of regulators – guidelines, openness

Some changes to expect are how local regulations will apply and changes in the behavior of regulators as MiCA comes into force.

- In Portugal: Bank of Portugal will regulate stablecoins/EMTs, CMVM will oversee CASPs
- Austria wants to start accepting applications as early as October 2024
- Lithuania is already preparing the regime and is favorable for EM companies.
- Malta is a common regime given the openness of the regulator.
- France is actively attracting firms to grow the fintech sector.
- Germany has a wider local market that is attractive for companies.

Passporting:

Companies can now use passporting rights largely without considering strictness of approaches – general EU laws will apply to the operations. Given that MiCA is an EU-wide regulation, there are two ways companies can operate: freedom to provide services (core activities in the domicile country and request to other NCAs to operate) and freedom of establishment (a company would establish local offices in different countries). NCAs would remain in contact on joint business supervision. While passporting makes it easier for licensed companies to operate in the EU, some companies with significant operations across multiple countries may require several offices.

UK and Switzerland in relation to MiCA:

UK is similar to the US in the approach towards crypto regulation but less intense and is likely to diverge from MiCA in its approach, specifically on the stablecoin question. Both UK and Switzerland are considered “third countries” in the context of MiCA and companies from there have other requirements than EU-native firms.

FinCEN moves to cover RIAs and ERAs

PolicyPartner is examining the impact of the RIA/ERA rule published by FinCEN this week as many VC firms active in the crypto space would face new compliance obligations under the rule. **The rule is also proof FinCEN has wide discretion to designate new BSA entities. However, testimony at the HFS hearings this week offer a preview of the logistical and political challenges that await if FinCEN were to move to designate computing and software.**

RIA/ERA VC Crypto firms which would be affected (non-extensive):

- Galaxy Digital (RIA)
- Polychain (RIA)
- A16z (RIA)

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- Jump Capital (ERA)
- Standard Crypto (RIA)
- Infinity Ventures (ERA)
- Dragonfly Capital (RIA)
- DBA (ERA)

The [new NPRM](#) now brings ERAs into the fold of covered investment advisers for AML rules, following a previous NPRM in 2015 just for RIAs.

“Accordingly, this proposed rule would establish AML/CFT requirements for RIAs and ERAs. In full, the proposed rule would require RIAs and ERAs to implement an AML/CFT program, file Suspicious Activity Reports (SARs) with FinCEN, keep records relating to the transmittal of funds (Recordkeeping and Travel Rule), and other obligations of financial institutions under the BSA.”

The concept was included in the Department of Treasury’s [2024 Investment Adviser Risk Assessment](#). Notably, CIPs and CIDs are not a part of this rulemaking, but Client Risk Assessments will still be a large segment of programming. It is expected that in future rulemakings CIPs will be addressed. Additionally, the proposed rule does not cover state-registered investment advisers. **Any comments on the NPRM must be made by April 15, 2024 here. When the final rule becomes effect, covered advisers will have 12 months to comply.**

Republicans lose a House seat, undermining an already slim majority.

With George Santos’ seat flipping democrat in the special election, the Republican majority shrinks further. Although Republicans were able to successfully impeach DHS Head Mayorkas, challenges in doing so highlight the difficulty Republican's might face on other issues. However, legislating crypto issues is not a party line split in the House, members like Rep. Torres and others could push a floor vote on a crypto issue across the line.

However, the border and the budget are top of mind for policymakers. Even in crypto, actions to counterbalance the AML narrative started by Sen. Elizabeth Warren has taken up valuable time – the two key digital assets problems, market structure and stablecoins, still need work and bipartisan compromise.

From our conversations with the House Financial Services Committee this Friday, HFSC and Ag committees continue to tinker with the market structure bill, with most optimistic timeline aiming for a floor vote in May.

House Financial Services Committee right sizes AML narrative.

House Republicans delt a serious blow to the creditability of the AML craze begun by the erroneous WSJ report and subsequent calls for legislative action by the left. While it is often difficult to achieve concrete wins in oversight hearings, questioning of undersecretary Nelson confirmed that the WSJ report is incorrect, and that crypto was not the primary tool for financing Hamas (only 1% of illicit activities). PolicyPartner was previously

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concerned that classified briefings indicated a higher level of crypto traffic, but this testimony eliminates that possibility. **That admission is likely a serious blow to Senate Democrats' effort to enhance crypto AML/CFT measures.**

The discussion continued as Digital Assets, Financial Technology and Inclusion Subcommittee held a hearing on "Crypto Crime" on February 15th looking at approaches to restrict illicit activity. The hearing primarily focused on challenges posed by **offshore exchanges**, the use of mixers, and DeFi protocols – majority of illicit activities occur in less regulated offshore exchanges, necessitating cooperation with international bodies like FATF to enforce AML/CFT standards globally. Legislative proposals included expanding the US Secret Service's authority, establishing an Office of Innovation within FinCEN, requiring studies on DeFi, examining privacy-preserving technologies, and setting up an information-sharing pilot program for combating money laundering in crypto transactions.

Takeaways from PolicyPartner call with HFSC

- Senate is biggest hurdle for productive legislation from the house. Hawkish senators were rather concerned by the SEC's loss against Ripple, incentivizing more enforcement and doubling down on harsher legislation. Senior staff highlighted that another route to slow down the industry is through rulemakings from the SEC. While not breaking, the call confirmed our general understanding that case law will likely be one of the key drivers of policy for quite some time.
- Timelines: first the HFSC and the Ag committees need to tie the texts together. Optimistic timeline is the following: push to be in the queue by the end of February to get passed out of committee by end of April and get to the floor by the end of May. Pessimistic timeline: push for MS / SC bills to be considered in the fall.
- Prometheus offering ether custody is important as it is one of the first times a firm would be offering custody through the ATS. Based on the SPBD safe harbor mandate, Prometheus can only custody securities, and them custodying Ether could put the ETP question to be more acute. Our conversations with attorneys close to this structure indicate **these services might not be the ultimate referendum on ETH's status as a security** as securities, (even if improperly registered) can be freely traded a year and a day after issuance – an area where we are doing more research.
- Question of sufficiently decentralized: The only thing that came up in the discussions is the question about timing on when tokens are considered distributed for the purposes of a 12-month lookback period. **One of the key criteria is whether the tokens are generated in the genesis block - If the tokens are generated in the genesis block they are considered issued at the time of their creation and not at the time of distribution.** The purpose of the consideration is to clarify the rules for foundations with tokens that have programmatic distributions. To be considered sufficiently decentralized all programmatic distributions in the last 12 months had to be end-user distributions. Amnesty for the past operations is one of the reasons for the provisional registration outline in the notice period part of the MS Bill.

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- Stablecoins: Senate packages and deals could influence the readiness to move forward with the stablecoin legislation. Meanwhile, senate banking leadership emphasized that the stablecoins could be a part of the deal. More specifically, Senator Brown expressed interest in doing BSA/AML legislation which could include stablecoins.

Letitia James presses DCG

New York Attorney General Letitia James expanded the [October 2023 lawsuit](#) against Gemini, Genesis, and DCG for defrauding investors who used the Gemini Earn program. The newly [amended complaint](#) now charges DCG and others for the defrauding of investors of \$3 billion. The Office of Attorney General (OAG) is using the suit to call for greater regulations on crypto to protect investors, despite NYDFS having some of the strictest crypto regulations in the country. The OAG of NY will likely continue large investigations of crypto agencies operating in NY. This lawsuit will also likely spend significant time in courts as a DCG spokesperson stated the complaint to be “baseless” and that DCG “will fight the claims aggressively.” Previously, Letitia James was vocal about NYDFS regime being too lenient for crypto companies.