
Brussels, 12 July 2024

Dear Ms Cazenave and Mr Ostermann,

The European Blockchain industry remains strongly supportive of the Markets in Crypto Assets Regulation (MiCAR) and continues to work hard to prepare for implementation. We are very grateful for all the work that ESMA has done to prepare the many 'Level 2' mandates, and have appreciated the collaborative approach to engaging with the industry on the points we have raised.

We are writing to you now as regards an important Level 1 interpretative issue that we understand you are working on, namely as regards the different types of business models and permissions that may be sought by crypto asset service providers (CASPs) and how national competent authorities will set about authorising these different models.

We understand that some supervisors have raised concerns about EU CASPs who may act as intermediary brokers who route orders to non-EU liquidity venues. With a fraction of global crypto volume traded in the EU, allowing CASPs to route to global liquidity pools is critical to facilitate the best possible execution outcomes for EU residents, promote healthy competition in the growing EU crypto asset market and ensure that EU users are able to access crypto assets through deep markets at the best possible price.

The broker permission model enables EU clients to benefit from efficient price formation occurring in global crypto-asset markets. Not permitting broker models will effectively prohibit access to global liquidity pools and result in a segregated EU market with significantly less liquidity and market depth. This would likely result in material adverse effects for EU customers, undermining one of the key objectives of MiCA. In particular, EU users may face a range of additional risks including increased price volatility, more slippage in pricing, shallow order book depth and reduced trading efficiency. The risks posed by a segregated EU market with shallow liquidity is also likely to significantly hinder increased participation by institutional investors, who may be unable to execute large orders without significantly impacting market price.

This is an important topic for many EU CASPs already set up as brokers, and we wish to relay our views on why we think this model should not be constrained or prohibited.

Moves to constrain or prohibit order routing would go against the Level 1 Regulation.

MiCA provides for a range of permissions, with distinctions between authorisation to operate a full trading platform to authorisations to receive, transmit and execute orders (amongst others). MiCA clearly envisages that different firms may apply for different permissions based on their business models, and acting as an intermediary broker with permissions for receipt and transmission of orders (RTO) and execution of orders is one of the clearly articulated and accepted models envisioned by the MiCA framework. Similarly, CASPs can also operate under a dealer model using proprietary capital and relying on the regulated service of exchanging digital assets against other funds or other digital assets. Furthermore, a broker-dealer model is also explicitly contemplated by ESMA itself in paragraphs 198 and 201 of the MiCA Level 2 consultation paper published in October last year.

MiCA already ensures that intermediary brokers are subject to substantial regulation as CASPs legally performing activities in the EU.

MiCA contains extensive requirements on CASPs which require that any MiCA authorised broker maintain a substantive presence within the EU. These include requirements on: (a) governance and meaningful presence in the EU; (b) prudential capital; (c) resources (including technical and human resources); (d) outsourcings; (e) custody and (f) internal control functions.

In addition, market abuse requirements apply to persons professionally arranging or executing transactions (PPAETs) which - as established in the last ESMA consultation in relation to market abuse requirements - encompass brokers¹ transmitting orders and / or using proprietary capital. Finally, EU CASP acting as brokers will in any case have to comply with rules on best execution as provided under MiCA, which is an effective way to protect users and meet the purpose of MiCA.

Trading platforms operating in the EU are subject to express requirements to ensure they do not list crypto assets where non MiCA-compliant white papers have been published. However, national competent authorities have the power to require intermediary brokers, where they deem a particular asset to be non MiCA-compliant and do not want it available to EU clients, to geofence the asset so it is not tradeable in the EU. To the extent that MiCA leaves any ambiguity with regard to the potential for intermediary brokers to execute client orders for non-MiCA compliant tokens, there are far more effective mitigating measures to address this - such as geofencing and prominent risk disclosures - in lieu of order-routing restrictions which create significant liquidity loss and volatility for EU customers.

These provisions are sufficient to ensure that regulated activity occurs within the EU, and enable regulators to effectively exercise their supervisory functions over CASPs. The reliance on a broker model does not mean that applicable whitepaper or other risk disclosure requirements of MiCA will be circumvented. We do not see the need to impose additional Order Routing Restrictions to ensure that EU clients are facing a substantive entity subject to effective EU supervision, as this approach would be disproportionately harmful to customer interests and unnecessary to achieve the objective at hand. It would create significant market disruption, increase volatility, adversely impact prices at which EU residents are able to trade, and reduce the value of assets they already hold. We also think any order routing restriction could incentivise unwanted arbitrage practices from parties able to take advantage of global liquidity pools.

The ability of CASPs to act as intermediary brokers is consistent with traditional financial services rules.

Cross-border order routing is in line with traditional financial services rules. In a traditional financial services context, it is standard practice for EU client-facing brokers to route orders to overseas venues for execution, and this position is consistent with MiFID II. This existing market practice is confirmed by regulatory disclosures for a number of EU retail brokers (including MiFID II mandated 'RTS 28' best execution reports), which demonstrate significant use of non-EU execution venues. It is vital for intermediary brokers to be able to use such venues in order to access third-country liquidity to achieve high quality execution for their clients - and in a MiCA context this is even more important due to the global nature of crypto asset markets. While there is a degree of variation

¹ Consultation Paper Draft technical standards and guidelines specifying certain requirements of the Markets in Crypto Assets Regulation (MiCA) on detection and prevention of market abuse, investor protection and operational resilience – third consultation paper, para 37.

in crypto regulation in different jurisdictions, this does not interfere with the EU NCAs ability to supervise MiCA entities within their jurisdiction.

Some EU CASPs are already well established as brokers. MiCA entered into force in June 2023. It is of concern that a year later, and only six months before MiCA rules for CASPs enter into application, a novel interpretation of the text that would herald significant disruption at the business and market level, would be contemplated.

Establishing an onshore exchange is not a trivial undertaking, and moving to this from a broker model would require very significant infrastructure building and testing. This might not be feasible in the short time left in the implementation period before MiCA rules enter into application for CASPs, leading to potentially significant service disruptions and market shock for EU customers.

Convergence and level playing field.

We fully support ESMA's drive to ensure supervisory convergence, and we think that this can be achieved via guidance on the types of criteria that NCAs should take into account when assessing if they should authorise CASPs seeking a MiCA broker permission in their Member State. These criteria could include whether the broker will:

- Geofence non-MiCA compliant tokens to ensure they are unavailable to EU clients;
- Provide easy, direct access to transparent, clear disclosures about listed tokens to EU clients to ensure they are able to appropriately engage on the risks associated with trading in those tokens;
- Have sufficient substance and governance in the MiCA CASP to enable direct ongoing supervision by the relevant NCA without any third entity or third country interference;
- Actively manage conflicts of interest with any non-EU exchange to which it routes orders;
- To the extent it offers custodial services, hold EU customer assets secure and insolvency remote from the non-EU exchange, with client assets custodied within the MiCA CASP.

We respectfully ask ESMA to reconsider issuing an Opinion that might amount to a *de facto* blanket ban on routing EU customer orders to global liquidity pools. There may be instances where an individual supervisor may consider a particular broker and third country model to be un-supervisable, in which case they already have the grounds in the MiCA Level 1 text to withhold authorisation. Case by case assessment, based on common principles to foster convergence, is a more prudent approach in our view.

We are at your disposal to discuss this important matter further.

Yours sincerely,

Robert Kopitsch
Secretary-General
Blockchain for Europe