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Digital Assets in 2024

by **David Naughton, Narita Woods**

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A Consideration of Some Legal, Regulatory and Market Trends.

The legal and regulatory sphere for digital assets is changing at pace. Technological advances and consumer demand are pushing the Central Bank of Ireland to develop enhanced frameworks to facilitate investment in this asset class. At EU level, the focus is on developing a harmonised approach, with the much-anticipated Markets in Crypto Assets Regulation (MiCAR) coming into force later this year. As novel business services and investment offerings are being created to meet a growing investor appetite for new ways to accumulate and store value, David Naughton and Narita Woods (LK Shields) consider the shifting plates underpinning the treatment of digital assets in our existing financial services framework.

The Existing Digital Asset Legal and Regulatory Framework in Ireland

The current definition of a ‘virtual asset’ is broad. It is in line with the Financial Action Task Force’s recommendations, of which Ireland is a member, and provides that this asset class is:

“a digital representation of value that can be digitally traded or transferred and used for payment or investment purposes, but does not include digital representations of fiat currencies, securities or other financial assets.”

Firms dealing in digital assets are currently authorised and regulated in Ireland as virtual asset service providers (VASPs), under the Central Bank’s anti-money laundering (AML) regime and its fitness and probity regime, rather than pursuant to a distinct sector code.

There are currently eleven VASPs authorised by the Central Bank, with the most recent market entrant being Ripple, registered in December 2023.

Unlike the U.S., which has a plethora of regulators for different aspects of financial services regulation, and related territorial and political partisan challenges; in Ireland the Central Bank has primary responsibility for financial policy, consumer protection, prudential regulation, AML and market integrity albeit the Competition and Consumer Protection Commission and the Department of Justice also have designated responsibilities in certain aspects of some of these areas.

While UK legislation and the FCA taxonomy of digital assets are close to the MiCAR text, referencing distributed ledger technology (DLT) and digital representations of value or contractual rights, Brexit is unlikely to result in ongoing harmonisation with the EU in this area.

As such, the existing legal and regulatory framework in Ireland, with appropriate enhancements to accommodate developments at EU level, is well-placed to make Ireland an increasingly attractive location for market participants as investor appetite for exposure to digital assets evolves.

Recent EU Legislative and Regulatory Developments in this Area

MiCAR

Issuers and offerors of digital assets will be subject to authorisation and regulation by the Central Bank when MiCAR comes into force in 2024, creating a common set of rules for such issuers and offerors and entities looking to provide regulated digital asset services such as crypto-exchanges.

MiCAR introduces a common taxonomy of digital assets by differentiating between three types of digital asset, with regulatory requirements for each:

- Asset referenced tokens (ARTs).
- E-money tokens (EMTs).
- Other digital assets (a catch-all for all other digital assets not regulated under existing EU financial services law and regulation).

MiCAR's provisions on ARTs and EMTs will come into force in June 2024.

The remaining regulations, including those applicable to other digital assets and crypto asset service providers (CASPs), are scheduled to come into force in December 2024.

VASPs have until 29 December 2025 to seek authorisation as CASPs.

ESMA work on MiCAR

ESMA has just released its first rules on CASPs as well as a third consultation which is seeking industry input on market abuse detection and reporting, transfer services policies including clients' rights, suitability requirements for certain services, portfolio management periodic statements and ICT operational resilience for certain in-scope entities.

This expeditious development of a robust framework in conjunction with industry seeks to ensure the framework is workable and that there is cohesion across member states in the EU, reflective of the process adopted in the recent implementation of adjustments to the Payment Services Directives in the EU.

DAC 8 Reporting

DAC 8, an EU Directive amending Directive 2011/16/EU on administrative cooperation in the field of taxation, effective from 1 January 2026, requires information exchange and mandatory reporting for CASPs and digital assets operators, with the policy objective of increasing tax transparency and safeguarding investors across the EU. Industry is currently assessing the impact of DAC8 on their operations.

4 Current Central Bank position on investment in digital assets

In the regulated investment funds sphere in Ireland, the Central Bank has evolved its view on investment in digital assets to the following positions:

- Where a QIAIF proposes to invest up to 20% of its net asset value in digital assets, a QIAIF may be structured as having open-ended liquidity provided that the portfolio as a whole is determined by the AIFM to be suitable for an investment fund providing open-ended liquidity.
- Where a QIAIF proposes to invest up to 50% of its net asset value in digital assets, the QIAIF must have either limited liquidity or be closed-ended.
- It is interesting that the Central Bank's approach in relation to investment in digital assets by investment funds is dynamic, with ongoing review and potential future enhancements as EU regulatory discussions evolve.

Industry challenges

Investment Firms

Several categories of digital asset fall outside MiCAR, including certain non-fungible tokens, assets that qualify as financial instruments under MiFID II and digital currencies issued by national central banks, being a digital form of a fiat currency.

According to Darren Freemantle, Bitcoin Educator and Consultant at SineWave, it is a *“challenge to map ART, EMT and CASP definitions to emerging and existing projects*” and the regulatory challenge lies in *“evolving existing frameworks at sufficient pace as to not stifle innovation”.*

However, Darren notes that *“it is often overlooked that exposure to digital assets can be achieved via traditional markets”.* Portfolios can hold positions in bitcoin mining companies or exchange-traded funds that invest in them.

Tokenisation of #TradFi Assets for Investment Fund Portfolios

Tokenised forms of traditional cash and shares are expected to be classed as ARTs, although uncertainty remains around whether digital assets are ‘commodities’. Darren Freemantle cites the SEC’s current review of Ethereum spot ETFs, seemingly leaning towards a commodity classification because of a *“decentralised protocol with no issuer”*.

AI Technology in Funds Servicing and Custody Sectors

The processing benefits of AI in NAV calculations and settlement processes may bring more efficiencies and opportunities to service greater numbers quicker and more accurately. Implementation here is a current challenge.

~ *Alexa (or other ubiquitous voice-commanded domestic AI)*, how much have I got in my crypto wallet?

While DLT may be a more democratised way of generating wealth, it is at odds with current centralised forms of finance in financial institutions and current requirements for custody and safekeeping.

Fund administrators, depositaries and management companies are focused on the need to safeguard against theft, money laundering risk, operational resilience and seeking to ensure a clear basis of valuation in this emerging digital space.

Market Trends

The question of what constitutes a digital asset and a VASP has been a hot topic in practice over the past year, as entrepreneurs across the globe look to harness appetites for this new wealth universe. Other market trends include a consideration of potential offerings for blockchain ecosystem operators in crypto-coins / fiat currencies exchanges on digital trading platforms, proprietary and white-label digital wallets to hold tokenised assets, phone apps to resolve travel disruptions, trading of ticketed events on a secondary digital market and tokenisation of money and vouchers traded on proprietary digital platforms. Investor demand for market solutions to enable digital assets to become a credible store of value – effectively digital gold – means innovation, which was happening gradually, is now happening suddenly.

What’s Next?

As some have commented, what we are witnessing is:

Pushmi-Pullyu: the never-ending balancing of new tech and services with consumer protection.

The Central Bank’s position on protecting consumers is clear, but it has also signalled its adaptability in line with its proportionality, predictability and reasonable expectations ethos. Indeed, the Central Bank’s welcome launch of the Innovation Hub seems to have two key objectives: helping tech start-ups in the financial services sector, while facilitating the Central Bank in gaining insights into new technologies created for market opportunities, thereby assisting advanced policy making to protect investors.

We anticipate this regulatory engagement, in embracing new forms of financial services and products, will continue, supporting our industry in Ireland in its continued growth and sophistication, which can benefit all investors.

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