

ESMA Response to FTX Collapse

The European Securities and Markets Authority (“ESMA”), Europe’s super-regulator, has issued a statement regarding the collapse of FTX and its implications for the European Union (“EU”). This was delivered to the Economic and Monetary Affairs Committee of the European Parliament.

Background

FTX was one of the largest crypto-trading exchanges until its sudden collapse in November 2023. It was headquartered in the Bahamas and operated through a complex web over 100 affiliated entities domiciled in jurisdictions across the world. As an exchange, its services included facilitating the purchase and sale of cryptocurrencies as well as derivatives based on these. It provided its services to a global client base.

Nexus to the EU

Although FTX itself operated outside the EU, it had a subsidiary entity, FTX (EU) Ltd, domiciled in Cyprus and which was supervised by the Cyprus Securities and Exchange Commission. The activities of this entity were suspended on 11 November 2022. FTX also had European users of its services, although this is estimated at under 10% of the over 1 million users registered with the service.

EU Response

ESMA notes that it was not responsible for either the regulation or supervision of FTX and therefore its access to relevant information is confined to that available in the public domain. It notes that from an initial review key regulatory concerns with FTX appear to be a failure to adequately ensure the segregation of client assets, poor corporate governance generally and aggressive marketing. All of which were carried out in the context of a highly volatile asset class associated with extreme market risks. It notes that the warnings it previously issued with respect to

crypto currency investments highlighted these concerns in the general context of crypto investing, particularly by retail investors. National regulatory authorities across the EU, including the Central Bank of Ireland, also issued similar warnings at the national level.

ESMA expresses confidence that pending regulation of the area in the EU through the Markets in Crypto Assets Regulation (“MiCA”), discussed further below, is addressing the correct issues which will ensure protection for investors and market participants. It notes that in light of the FTX case there is a clear urgency in the implementation of this.

MICA

MICA was recently finalised and approved at the EU level and is expected to be effective across the EU in 2024. It seeks to regulate the crypto space by essentially subjecting service providers to similar requirements to those applicable to traditional financial institutions under legislation such as MiFID, as well as plugging perceived gaps in the EU regulatory framework by clarifying which services are covered by existing legislation and then including new services in the scope of this regulation. As a Regulation it will become effective without any further national level implementing measures. See our separate Legal Update on MiCA for further information. It is interesting to note that notwithstanding this pending legislative regime ESMA recognises that service providers located outside the EU are expected to continue to play a dominant role in crypto markets in the future and that therefore close co-operation with international counterparts will be necessary going forward in the crypto space.



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