Blockchain for Europe
Rue Montoyer 47
1000 Brussels
Belgium

Blockchain for Europe Response to ESMA's consultation he draft guidelines on the classification of crypto-assets as financial instruments under the Markets in Crypto Assets Regulation (MiCA)

Q1 Do you agree with the suggested approach on providing general conditions and criteria by avoiding establishing a one-size-fits-all guidance on the concepts of financial instruments and crypto-assets or would you support the establishment of more concrete condition and criteria?

Given the complexity and rapidly evolving nature of financial instruments and crypto-assets, a nuanced regulatory approach is essential. We endorse the Markets in Crypto Assets (MiCA) Regulation for its clarity and flexibility, which provide valuable guidance to market participants while fostering innovation within the crypto-asset industry. However, we caution against overly strict regulations, as they may stifle innovation and impede the development of new financial services. The endorsement of the MiCA Regulation reflects our belief that it not only offers necessary guidance but also stimulates further innovation within the crypto-assets space. By creating an environment that encourages responsible innovation while addressing potential risks, we can facilitate the continued growth and maturity of this dynamic sector. However, the absence of clear regulatory guidance poses a significant risk of market fragmentation, as evidenced by differing interpretations of the definition of transferable security by National Competent Authorities (NCAs), as outlined in the "ESMA Advice on Initial Coin Offerings and Crypto-assets." For instance, attempts to map the novel crypto-asset concept against the historic definition of transferable security yielded a range of outcomes. Notably, in case 5, there was unanimous agreement that the crypto-asset does not qualify as a financial instrument. However, in cases 1 and 2 within the ESMA Advice, which are among the most clear-cut in terms of interpretation as a financial instrument, almost a third of NCAs disagreed with the majority. This variability underscores the need for comprehensive regulatory frameworks to provide clarity and minimise market fragmentation, thereby promoting innovation and stability in the crypto-assets sector. 5 The guidance on the token perimeter in MiCA is therefore critical in aligning NCAs, and in helping MiCA achieve its core objective, as per Recital 1 "that Union legislative acts on financial services are fit for the digital age, and contribute to a future-proof economy that works for people, including by enabling the use of innovative technologies", particularly given the international nature of the crypto-assets market and the passporting regime in MiCA, we feel it is fundamental to strive for harmonisation to avoid some types of crypto-assets being considered Markets in Financial Instruments (MiFID II) instruments in one Member State, and MiCA instruments in another.

Q2 Do you agree with the conditions and criteria to help the identification of cryptoassets qualifying as transferable securities? Do you have any additional conditions and/or criteria to suggest?

Please illustrate, if possible, your response with concrete examples. We believe in designating crypto-assets as financial instruments if the nature of the underlying asset qualifies as such

Blockchain for Europe
Rue Montoyer 47
1000 Brussels
Belgium

under MiFID II. As a general approach, we recommend that a crypto-asset should be classified in accordance with the nature of the underlying asset that it represents. Our approach prioritises substance over form, taking into account the specific features, design, and rights associated with each crypto-asset. For instance, a crypto-asset may be considered a transferable security if it grants rights akin to shares or bonds and digitally represents instruments that resemble shares or bonds. Further, we stress the importance of technology neutrality in classification, underscoring that the mere use of Distributed Ledger Technology (DLT) or cryptography does not automatically classify assets as financial instruments. 6 With the rise of digital assets like cryptocurrencies and tokenized securities, there may be discussions or proposals to amend MiFID II to specifically address the regulation of these assets. This could involve defining new asset classes, establishing regulatory frameworks for digital asset exchanges, and addressing investor protection and market integrity issues unique to digital assets. ESMA should also recognize that the fact that a crypto-asset can be traded for other crypto-assets or FIAT money is insufficient to qualify it as a transferable security. This is supported by results of a survey conducted by ESMA, which asked if various example tokens were securities or financial instruments, including a utility token as case 5. As ESMA explained: “only for case 5 there was unanimous agreement that the crypto-asset does not qualify as a financial instrument.” We agree that the fact that no NCA labelled utility tokens under case 5 of the above survey as a transferable security and/or financial instrument suggests that pure utility-type crypto-assets may fall outside of the existing financial regulation across Member States. The rights that they convey seem to be too far away from the financial and monetary structure of a transferable security and/or a financial instrument. Notably, the survey’s description of case 5 included that the token “can be sold for cryptoassets or FIAT money.” This shows the consensus view that capability for a token to be sold for FIAT money or traded for other cryptocurrencies was not sufficient to classify such a token as a financial instrument. Another MiFID II criteria is that it should be part of a “class of securities.” While “class” is not defined in MiFID II, we agree with ESMA that: “for crypto-assets to form a class, they should confer similar rights to investors.” However, one potential source of confusion is whether protocol governance is similar to the rights of investors. Accordingly, ESMA should clarify that blockchain projects’ governance processes, such as protocol improvement proposals, and the 1 ESMA’s 2019 survey of EU Member States’ NCAs (ESMA50-157-1384 Annex 1) 7 ability to participate in them is not “similar” to “voting rights on the issuer's decision-making process,” as they don’t control the issuer’s decisions. Although ESMA indicates that the notion of ‘expectation of profit’ is not a concept that is defined or even used to qualify a financial instrument under MiFID II, this could be understood as the transformation of an economic function into a qualification criterion, which has no clear legal basis within Union law. Consequently, unless the investor's intention were to become a qualifying criterion, the ‘only investment’ component would not be self-sufficient to qualify a crypto-asset as a transferable security.” Therefore, we agree with ESMA’s conclusion that an ‘only investment’ component should not be sufficient to qualify a crypto-asset as a transferable security, and caution against adding an investor’s intention as a qualifying criterion. For what concerns debt, we would recommend considering further the situation described in paragraph 104 where an instrument is used in a way that “represent[s] a debt akin a monetary debt like [a portion of] a loan … should be considered as securities”. Given the versatile nature of crypto-assets and their ability to be used in different ways by

Blockchain for Europe
Rue Montoyer 47
1000 Brussels
Belgium

different people and projects, it should be clarified if the intention here is to suggest that the instrument in question becomes a security only when used in this way, or whether the classification of that crypto-asset becomes fixed generally, based on this use case. This raises a wider question (beyond just debt instruments) on how crypto-assets should be classified when the way they are used, in only one particular circumstance, causes them to have relative outcomes akin to a MiFID instrument - but when used outside of that context, they do not. The versatile nature of some crypto-asset types means that they can be used in many different contexts and with different relative outcomes, some of which may look akin to MiFID instruments, and some of which will not. Our view is that the crypto-asset should only be considered a MiFID instrument in the contexts where it is used as such, and that crypto- 8 assets should not be considered a MiFID instrument in contexts where they do not seek to offer relative outcomes akin to MiFID instruments. Based on this, we believe that further guidance should be provided to clarify that the classification of a crypto-asset as a security in one context does not mean that the same crypto-asset will be considered a security in all other contexts.

Q4 Do you agree with the conditions and criteria to help the identification of cryptoassets qualifying as another financial instrument (i.e. a money market instrument, a unit in collective investment undertakings, a derivative or an emission allowance instrument)? Do you have any additional conditions, criteria and/or concrete examples to suggest?

We agree with the conditions and criteria presented by ESMA. We would like to underline that emission allowances are fundamentally different from most crypto-assets currently on the market, which often represent a store of value, a stake in a project or access to a service. If a crypto-asset classifies as a financial instrument under MIFID II i.e. the emission allowance or another financial instrument, should be dependent on the same criteria as other cryptoassets thus should represent a right to emit a specified volume of greenhouse gases. If this is the case such crypto-assets should represent the right to emit a certain quantity of greenhouse 9 gases and be recognised for compliance with the EU Emission Trading Scheme, falling under the MIFID II's remit. At the same time, we would like to stress that crypto-assets can vary significantly when it comes to their environmental impact. The vast majority of crypto-assets are designed in a way that has an environmentally friendly way of processing transactions. The environmental impact of different crypto-assets can indeed vary significantly depending on various factors such as the consensus mechanism (i.e. PoW, PoS, PoA and so on) they use, the energy efficiency of their underlying blockchain technology, and the sources of energy used for mining, as well as any positive environmental impact generated by the projects and use-cases developed on the underlying blockchain protocol. Considering all these factors, it's essential for investors, regulators, and stakeholders to assess the overall environmental implications of different crypto-assets and consider them alongside other factors when evaluating their potential risks and benefits. Additionally, promoting transparency and encouraging sustainable practices within the crypto industry can help mitigate environmental concerns associated with crypto-assets. MiFID II also refers to units in "collective investment undertakings" as financial instruments. Importantly, "collective investment undertakings" require that "the undertaking does not have a general commercial or industrial purpose," in accordance with the ESMA Guidelines on key concepts of the

Blockchain for Europe
Rue Montoyer 47
1000 Brussels
Belgium

Alternative Investment Fund Managers Directive (AIFMD). A commercial purpose is the "purpose of pursuing a business strategy which includes characteristics such as running predominantly a commercial activity, involving the purchase, sale, and/or exchange of goods or commodities and/or the supply of non-financial services." Some crypto-assets have utility, which is to say a commercial or industrial purpose, such as tokens which can be exchanged for goods or commodities and/or the supply of non-financial 10 services. Accordingly, we suggest ESMA clarify that crypto-assets with utility or a general commercial or industrial purpose, even if they are not "utility tokens" as defined by MiCA, cannot be considered financial instruments as a collective investment undertaking.

Q5 Do you agree with the suggested conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets? Do you have concrete conditions and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

Clear differentiation of MiFID II financial instruments and MiCA crypto-assets is crucial in order to achieve a successful regulatory framework for crypto-assets in the EU. It is not only essential for regulators and NCAs to have clarity around rules applicable to assets on the market, but also for the market itself, so that companies issuing assets of a specific characteristic can be certain of what rules apply. The issue related to the classification of assets as financial instruments precedes the existence of crypto-assets. Today, there is no definition of a financial instrument in the EU, leaving this to the discretion of each Member State, which consequently, creates a risk of regulatory discrepancy. Traditionally, financial instruments such as stocks, bonds, derivatives, and investment funds have been subject to regulatory oversight and classified according to established frameworks like the MiFID in the EU and the Securities Acts in the US. These regulatory frameworks aim to achieve various objectives, including investor protection, market integrity, and systemic stability. They establish criteria for determining whether a particular asset qualifies as a financial instrument and outline the obligations and requirements for market participants 11 dealing with these instruments. With the emergence of crypto-assets, regulators have faced the challenge of applying existing regulatory frameworks to these new types of assets. This challenge arises from the unique characteristics of crypto-assets, such as decentralisation, programmability, and global accessibility, which may not fit neatly into traditional regulatory categories. In this regard, we agree with the suggested conditions and criteria to differentiate between MiFID II and MiCA crypto-assets, and we believe that it is essential for the NCAs to focus on the substance of the crypto-asset (i.e if the crypto-asset is a digital representation of a value, or rights) as well as to consider its technological characteristics and inherent programmatic capabilities, (including the way it is transferred, stored, and is designed) thus aligning with definition of crypto-assets within MiCA. In terms of utility tokens, we agree that while utility may be accompanied by governance rights, they should not replicate the rights attached to financial instruments, starting with those attached to transferable securities within the meaning of MiFID II. It is crucial to understand that, in contrast to shares, utility tokens should give neither financial rights nor voting rights which would grant an investor power in the corporate decision-making process. It is important to note that this is distinct from protocol governance. As noted in response to Question 2 above, ESMA should clarify that the ability

Blockchain for Europe
Rue Montoyer 47
1000 Brussels
Belgium

to participate in the governance of a DLT protocol, such as a protocol improvement process like Ethereum Improvement Proposals, are not the equivalent of a security holder's voting rights in the company's decision-making process. In many blockchain projects, the governance is decentralised, and the original issuer's role has come to a conclusion. Decentralised governance processes allow for improvements to the protocol, but are not mandates for the issuer's decision making process.

Q6 Do you agree with the conditions and criteria proposed for NFTs in order to clarify the scope of crypto-assets that may fall under the MiCA regulation? Do you have any additional conditions and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

Level 1 measures of MiCA have left the question of NFTs unclear, on the one hand stressing that NFTs are outside of the regulatory scope, while also stating that the issuance of large NFT series or collections may be considered as an indicator of their fungibility, therefore leading the collection to be covered by MiCA. This creates legal uncertainty for the issuers of NFTs, who cannot be sure whether and at what point these might be considered as crypto-assets under MiCA. It also ignores the principle for which it is the nature of the underlying asset that should determine the classification of a crypto-asset, not the technology, and therefore the appropriate regulations (if any). BC4EU strongly believes that NFTs should be classified based on the nature of their underlying characteristics and therefore urges ESMA to adopt final guidance that would reflect this approach, providing clarity on the legal status of NFTs being outside of the scope of MiCA. When NFTs are digital representations of underlying assets that would not otherwise trigger treatment as a financial instrument, subjecting them to MiCA would impose obligations that do not currently exist for other technologies. Take for example, event promoters that issue NFT tickets to a large event (e.g., 10,000 tickets), which entitle the NFT holder access to the event, just as a paper ticket would. While the NFT has been issued in a large series and may be transferable (similar to the real world secondary market that exists for event tickets), it does not otherwise resemble either an EMT, ART, utility token or any other fungible crypto-asset covered by MiCA. However, if MiCA were to apply to this minting simply due to the size of the "collection", event promoters who have opted to track tickets using blockchain technology would be required to draft a white paper regarding the NFTs, while event promoters who use 13 paper and electronic tickets that are tracked by QR codes or bar codes would not be subject to such requirement. Similarly, there are billions of physical trading cards printed each year, with some common cards being printed thousands (or even tens of thousands) of times in a single collection. For example, the Pokemon Company, a high profile producer of trading cards2 , has undertaken extremely large printings of trading cards (9 billion were printed between March 2021 and March 2022) to counteract speculation in the value of the cards and to preserve them for their primary purpose - to be used by users when playing a game. There has been no indication by ESMA that these cards could be considered financial instruments subject to regulation or that the size of their printings could turn them into a financial instrument. In fact, the size of these collections is indicative that they are not intended to be of value. The guidance, however, seems to indicate that if these large collections of trading cards were issued using DLT, they could be considered fungible crypto-assets and thus subjecting the issuers to a separate set of obligations and

oversight merely based on the technology used. To avoid disincentivizing innovative and non-financial use cases, ESMA should focus its guidance primarily on the nature of the underlying asset represented digitally by the NFT. This would determine whether the underlying asset should be treated as a financial instrument or subject to MiCA in the first place, regardless of the size of the collection or series. Therefore, BC4EU agrees that the NFTs assessment by NCAs should not be solely based on the technical specificities of NFTs. However, even the proposed "interdependent value test" aimed at classifying whether crypto-assets are unique and non-fungible within the meaning of MiCA, creates risks of legal uncertainty both from the perspective of a potential NFT issuer, 2 Nicholas Gordon, The Pokémon Company printed 9 billion Pokémon cards last year, doubling production to stop speculators scoring 350-fold returns on rare cards, Fortune (July 6, 2022). 14 who would not have legal clarity on how their NFTs will be classified, and from the perspective of regulators, that may differ in their application of the test, causing regulatory fragmentation. Issuers of NFTs and platforms that facilitate the purchase and sale of NFTs need to have full legal transparency and predictability in terms of what regulation they are going to be subject to, including at what point their NFTs will have to comply with MiCA's requirements. In this regard, it is essential to stress that, in principle, NFTs can represent all kinds of assets and rights that are not always intended to be financial in nature, including art, digital trading cards, real-world properties or digital content, which, just like their underlying equivalents, often are not subject to financial regulation and, as a consequence, of a licencing regime. Other types of NFTs, including those that represent proof of identity, voting credentials, and others, may not even be intended to have an independent value, as is assumed by the consultation. The application of MiCA to these use cases could unnecessarily stifle innovation for use-cases that were not contemplated to be, nor are appropriate to be, within the scope of MiCA. A nonfinancial instrument NFT which is minted as part of a large collection that has the same characteristics as, and may be interchangeable with, other NFTs in that collection should not fall within MiCA's scope simply because of these attributes. This is, in our view, the reason for which MiCA has excluded NFTs from its scope in the first place. Last but not least, as for the differentiation of crypto-assets from financial instruments, there needs to be a close cooperation at European level among various NCAs, particularly in exchanging experiences related to the classification of NFTs, in order to achieve a mutual level of understanding and avoid risks of regulatory discrepancies

Q7 Do you agree with the conditions and criteria proposed for hybrid-type tokens? Do you have any additional conditions and/or criteria to suggest that could be 15 used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

As in case of the classification of any other crypto-assets, also the classification of hybrid-type tokens should be based on the principle of "substance over form". In the context of cryptoassets, this principle is particularly relevant due to the unique nature of these assets and the challenges they pose for traditional accounting and regulatory frameworks. Crypto-assets often challenge traditional notions of ownership, control, and valuation, and the substance of a transaction involving crypto-assets may differ from its legal form, requiring careful consideration to accurately reflect the economic reality of the transaction. In this regard, the regulator should focus on the intrinsic characteristic of such an asset, and assess whether it displays features of a financial instrument, thus being subject to the MIFID II

Blockchain for Europe
Rue Montoyer 47
1000 Brussels
Belgium

regime. While Blockchain for Europe agrees that this assessment is a crucial part of the overall analysis, such assessment should take place concurrently with a broader examination of the asset, in order to receive a holistic understanding of the asset's characteristics. For example, as noted above in response to Q5, voting rights associated with protocol governance are distinct from voting rights associated with financial instruments. In order to properly understand the role voting plays in an asset's ecosystem, a more thorough analysis is needed beyond merely looking for the presence of a voting mechanism. We would like to underline that many of the existing crypto-assets on the market may be perceived as multi-purpose, i.e. being a means of payment or a store of value at the same time. Furthermore, in case of some assets, such attributes might also evolve over time, thus NCAs should be cautious in their assessment of asset classification. Moreover, hybrid tokens should not be treated in the same manner for all aspects. For example, one category of hybrid-type tokens are crypto-assets with utility. As noted above in 16 response to Q4, hybrid utility tokens have a commercial or industrial purpose, and thus should not be considered a collective investment undertaking. For hybrid utility tokens, they should be treated like a utility token for aspects of the token which provide access to a good or a service or that otherwise have a general commercial or industrial purpose. This matches the MiFID II language that exempts commercial or industrial purposes from a collective investment undertaking, and reflects the definition of "utility token" without the restriction that it be limited to a good or a service supplied directly by the token's issuer, thus capturing hybrid utility tokens that allow for goods or services supplied by a decentralised network. Thus, a hybrid utility token would be exempt from MiCA for those aspects that are part of its utility. This is similar to how tokens are exempt for tokens issued as a "reward for the maintenance of the distributed ledger or the validation of transactions," as are utility tokens "providing access to a good or service that exists or is in operation," and in keeping with Recital 22 which says "Where crypto-asset services are provided in a fully decentralised manner without any intermediary, they should not fall within the scope of this Regulation."